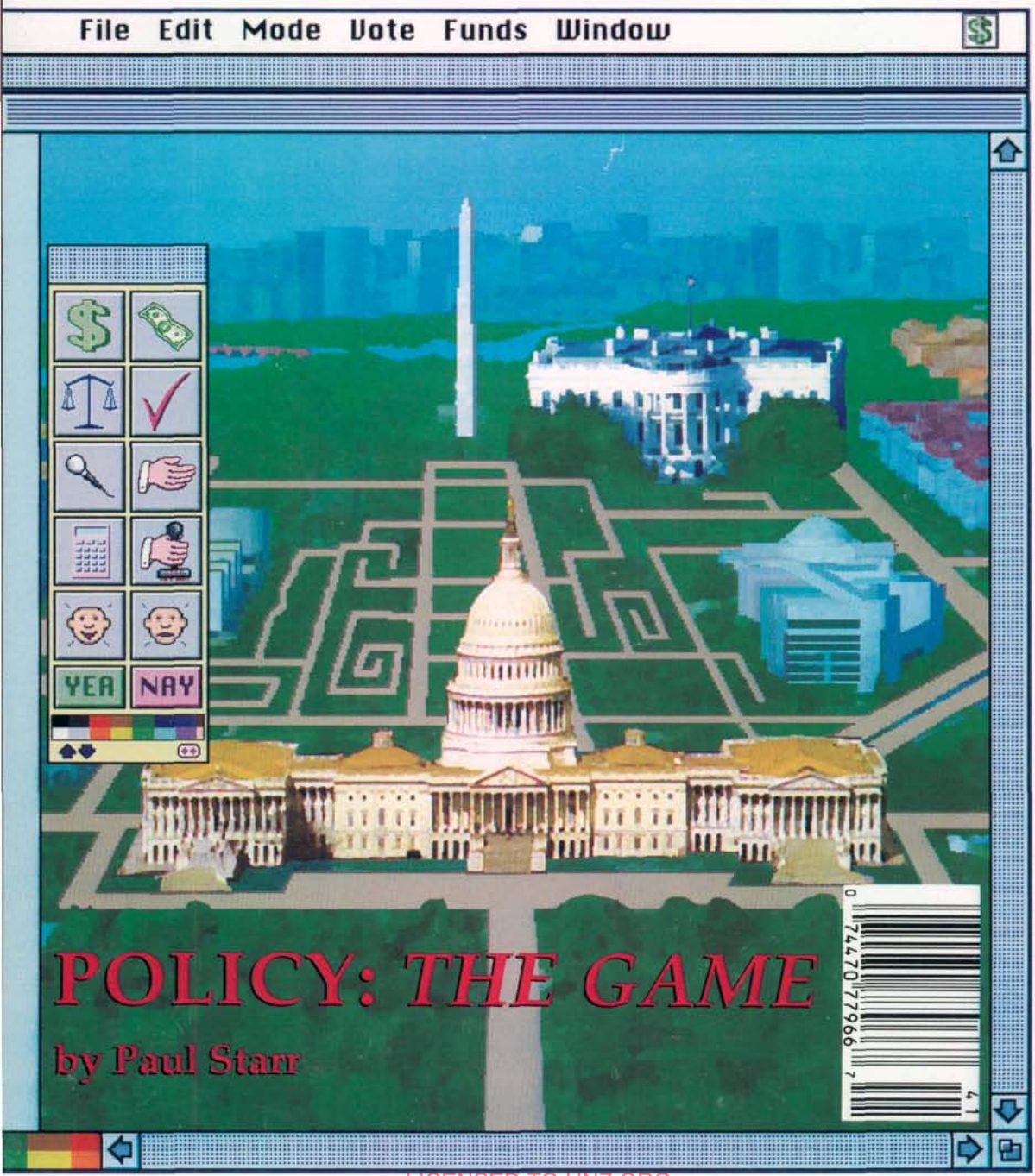
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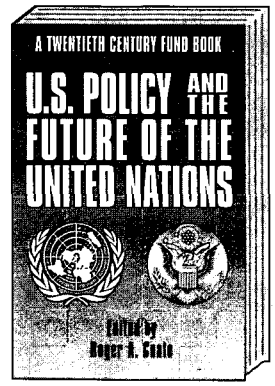
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A Journal for the Liberal Imagination

Spring 1994 Number 17

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Contributors

JAMES A. MORONE is associate professor of political science at Brown University and the author of *The Democratic Wish*.

MARCIA ANGELL, M.D., is executive editor of the *New England Journal of Medicine*.

RASHI FEIN served on the Council of Economic Advisers for President John F. Kennedy and is now professor of economics of medicine at the Harvard School of Medicine.

JEFFREY B. MORRIS is an ophthalmologist and a member of the clinical faculty of the University of California at San Diego School of Medicine.

EZEKIEL J. EMANUEL is an oncologist and ethicist at the Harvard School of Medicine.

JOAN E. RUTTENBERG is an attorney, consultant, and professor in the field of health law and policy.

SHOSHANNA SOFAER is associate professor of health care sciences at the George Washington University Medical Center.

ROBERT RESTUCCIA is executive director of Health Care for All, the largest state consumer health organization in the country.

JEROME H. SKOLNICK is professor of public policy, jurisprudence, and social policy at the University of California, Berkeley.

RANDALL KENNEDY is a professor at Harvard Law School and editor of *Reconstruction* magazine.

CHRISTOPHER HOWARD is assistant professor of government at the College of William and Mary.

RICHARD ROTHSTEIN is a research associate at the Economic Policy Institute.

FRANK ASKIN is a professor at the Rutgers University School of Law and a general counsel for the American Civil Liberties Union.

LOUIS LOWENSTEIN is professor of finance and law at Columbia University. His latest book is *Sense and Nonsense in Corporate Finance*.

RICHARD C. LEONE is president of the Twentieth Century Fund.

DEBORAH A. STONE, senior editor of *The American Prospect*, is on leave from Brandeis University as a fellow in the Program on Ethics and the Professions at Harvard University.

KENNETH P. RUSCIO is associate dean and assistant professor of politics at the School of Commerce, Economics, and Politics at Washington and Lee University.

ROBERT H. FRANK is the Goldwin Smith professor of economics, ethics, and public policy at Cornell University.

SISSELA BOK is a distinguished fellow at the Harvard Center for Population and Development Studies. She draws for this article on "TV Violence, Children, and the Press: Eight Rationales Inhibiting Public Policy Debates," Occasional Paper, The Joan Barone Shorenstein Center.

JONATHAN ROWE works on the staff of U.S. Senator Byron Dorgan. The views expressed here are the author's alone.

TODD GITLIN is professor of sociology and director of the mass communications program at the University of California, Berkeley.

COVER: BOB DAHM

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Only Connect

Robert Kuttner

The *New York Times Book* (sic) *Review* for March 6, 1994 ran a feature piece reviewing a CD-ROM. "Microsoft Art Gallery," an interactive digitized catalog of Britain's National Gallery collection, won a rave. Just point and click, and you can pull up paintings by artist, period, or genre; you can also get spoken critical commentaries and painter biographies; you can zoom in or print out, all for $79.95. The *Times*'s treatment of a CD-ROM as a virtual book has to be a kind of cultural watershed. The information revolution, decades after predictions of its imminence, has finally reached a popular critical mass.

Or, perhaps, a critical elite? Tens of millions of people now use electronic mail, computer bulletin boards, libraries and databases, or "telecommute" from home. Tens of millions more, many in such relatively humble jobs as checkout clerk and bank teller, routinely use computers at work. And after decades of rather pedestrian use of Macs and PCs in the classroom as adjuncts of rote learning, the potential of interactive multimedia pedagogy is at last beginning to permeate.

But if knowledge is power, one has to wonder who will get to use these marvelous, empowering tools. In principle, they are available to all, and at ever diminishing cost. A multimedia 486-level PC, complete with CD-ROM and fax-modem, is already available for under $1,500—less than most second-hand cars. Potentially, the enhanced PC will be the greatest boon to bootstrap learning since Carnegie's free libraries. This is surely the optimistic reading of Paul Starr's cover article on computer simulation games. One could imagine a world in which children from all social classes came of age learning to use this technology in grade school; Math Blaster would drive out Space Invaders, and computers truly would become the great equalizers. But will they? Will the information highway make us more connected as a people—or more separate?

In its architecture, the information age seemingly heralds equality. Not only is the hardware cheap and getting cheaper. The pricing structure of information itself is like no physical commodity; it is close to free. The economist Paul Romer emphasizes the powerful distinction between "rival" and "non-rival" goods in an information age. A rival good is a material object; if I have it, you can't have it. Information, as Romer notes, is the quintessential non-rival good. Once devised, a software package, a database, a learning program can be made available to all, at almost no marginal cost. Distribution is also nearly free, for pure information has no physicality. The designers of Bitnet, the inter-university computer network, acknowledged these factors when they devised "usage-insensitive pricing." Once you pay a basic membership charge, usage is free. Data manipulation is not metered, like usage of electricity or gas or the telephone. Bitnet's sponsors did this knowingly, to take advantage of the unique economic characteristics of pure knowledge—to maximize use rather than ration it by price, as we do in the allocation of rival physical goods.

Information networks deliver a kind of horizontal equity. Once a user is conversant with the technology, he or she is the equal

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of anyone else on line. The cyberworld is an almost-pure free marketplace of ideas. And as their enthusiasts keep telling us, computer networks are populist, free-wheeling, decentralized, and egalitarian, to the point of being splendidly anarchic.

Vertical equality, however, is another matter. It remains to be seen whether the computer will truly pervade the entire society in the manner of telephones, TVs, and cars. As they have become more user-friendly, computers have already become a commodity—but for an educated and relatively affluent segment of society. And if this remains the case, the information society will connect the educated, but intensify the separation of the classes. Without attendant efforts to overcome basic social inequalities, the presumed equality of access to technology will recall Anatole France's famous observation that the law in its majesty prohibited the rich and the poor alike from sleeping under the bridges of the Seine.

Beyond the question of meaningful access, the information society portends the intensification of other inegalitarian trends that have marked the recent past—if we let it. This is the pessimistic inference one can draw from reading four otherwise unconnected pieces in this issue of *TAP*: Starr's "Seductions of Sim," Richard Rothstein's "The Global Hiring Hall," Louis Lowenstein's "The Predators' Accomplice," and Robert Frank's "Talent and the Winner-Take-All Society."

Begin with Frank. In an essay stimulated by Derek Bok's 1993 book, *The Price of Talent*, Frank identifies a growing trend toward what he calls "winner-take-all markets." His metaphor is free agency in professional sports, which allows a few superstars, only marginally more skilled than their teammates, to reap astronomical salaries. A corporation is likewise a team enterprise. But as Frank and Lowenstein both suggest, financial manipulators often take the lion's share of the gain.

Winner-take-all markets reflect increased marketization on a global scale, combined with the information revolution. Globalization, mediated by cheap electronic information flows, sweeps away customary and regulatory barriers that once produced a more broadly equal distribution of earnings. Globalization/computerization also enlarges markets, which means that a Michael Jackson or a Nancy Kerrigan or a Microsoft Art Gallery now have the entire world as their stage—and their market. Obtain a brief monopoly niche, and you will get rich.

The information revolution implies widening inequality in several other ways. Robert Reich has observed that a global economy divides workers into symbolic analysts and routine drones. This is true *a fortiori* in an information society. The archetypal symbolic analysts include both Lowenstein's takeover artists (who often fail to add value) and Microsoft's monkish code writers—who add significant value. Some 2,200 of Microsoft's software writers are already millionaires, in holdings of company stock. In the slow lane of the information highway—I promise this will be the last metaphor—are the armies of people who merely work with computers, but routinely rather than creatively. Although today's bank teller/checkout clerk/claims processor is significantly more productive than her counterpart of a generation ago, her wage is on average 15 to 20 percent lower.

Why? The reasons include winner-take-all effects (more money to the takeover artists and computer programmers; less to routine computer clerks), as well as persistently high unemployment, which undercuts pressures to raise wages with productivity. And of course globalization of labor markets—facilitated by the same information revolution—puts U.S. workers into competition with the billions of underemployed workers of the Third World. Rothstein's global hiring hall depresses wages for routine workers with nothing special to sell. And the same globalization of markets makes it harder to organize unions, or for existing unions to succeed in

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their traditional mission of raising the incomes of wage workers.

More troubling and more subtle is the fact that the information society seems to confer new legitimacy on these widening inequalities. If freer and freer markets dictate that Microsoft CEO Bill Gates is worth $7 billion and that the local checkout clerk is worth $4 an hour, it must be so. In Mickey Kaus's rendition of the winner-take-all argument (in his 1992 book *The End of Equality*), the rising forces of inequality not only reflect merit; they are so well entrenched that it is futile to fight them. Offsetting civic forces—unions, regulation, the redistributive welfare state—supposedly frustrate desert and hence economic efficiency.

In George Gilder's version of the story, in his 1989 book *Microcosm*, laissez-faire economics are inherent in the new cyber-economy. The old mass-production economy was centralized, standardized, and routinized. It lent itself to hierarchies, to unions, to state regulation, to uniform wages, to stability. The new information economy is above all decentralized and democratic, fluid and unpredictable. Gilder proclaimed an age that would "overthrow matter" and define worth in terms of ideas. "Rather than a New Industrial State, this era will disclose the new impotence of the state." If you have the smarts to open a software boutique, all it takes is a home computer and imagination. In the information economy, you can found a billion-dollar company in your garage. Go for it.

Implicitly, if you don't get with the program you've only yourself to blame. In the emerging parable of merit and reward, the millionaire cyber-nerd at Microsoft is the information-age counterpart of the urban Korean grocer, already a famous neo-conservative icon as a latter-day Horatio Alger. If Korean grocers can make it in America, working the entire family 15 hours a day, why can't inner-city blacks make it? It must be their own fault. A generation ago, *Washington Post* cartoonist Herblock lampooned the conservatism of Barry Goldwater, heir to a dry goods chain, by having him lecture an urchin: "If you had any initiative, you would go out and inherit a department store." It is somewhat harder to parody Gilder lecturing children of the slums to learn computer programming.

Cyber-economics is Adam Smith economics in a second sense. The technology is presumably moving so fast that it can't (or shouldn't) be regulated. Even a decade ago, one could differentiate the computer industry from the software industry from the telephone industry from the broadcasting industry from the cable industry from the entertainment industry—each with its own regulatory schema. Regulation was predicated either on monopoly (telephones, cable) or on scarcity (broadcasting). Now these are all blending into one undifferentiated whole, with giant mergers paving the way and yielding more winner-take-all windfalls in the process.

If scarcity was the predicate of the 1934 Communications Act, there is no longer scarcity on the supply side. We can have an infinite supply of information offerings and interactions. There is of course scarcity on the demand side—one's ability to partake is limited by one's purse—but this is an afterthought. In his recent paper on the administration's information policy, Vice President Gore generally accepts the premise that we should substitute competition for regulation. Make sure that every home has at least two competing, full-service vendors of interactive services, and then let market forces rip. To equalize the demand side, Gore is for mandates and compensatory outlays, too. But given budgetary constraints, the temptation will be to leave the demand side to the market.

All of the foregoing means that for those of us who worry about deepening inequalities, the information age is tantalizingly double-edged. Looking backward, we may discover that the widening inequalities of the Reagan

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era—based largely on shifts in tax and transfer policy—were only stage-setters. The new inequality is based on deeper forces—a blend of technology and a resurgent market, with all the implied moral legitimacy that confers.

For example, the "virtual corporation," previously mentioned in this space, consists of a small core of entrepreneur/owners and an outer circle of contingent employees. The concept is touted not just as a useful strategy of corporate downsizing. It also carries ideological weight. It is not accidental that the metaphor—virtual—is cybernetic, for the information highway facilitates a loose corporate web connected by modem rather than physical affinity or long-term relationship. The worker brings to the marketplace only his human capital. The virtual corporation pays only for the value the worker can add. If the worker gets weary of the insecurity, the solution is obvious. He should become an entrepreneur himself. We are all Bill Gates—or at least we should be.

The presumption of a level playing field, in which everything is meritocratic, is of course mythic. Even if opportunities were truly equal, which they are not, it is hard to imagine a viable society composed of cyber-billionaires and data-entry drones.

An information economy does generate some mid-range jobs that are the cybernetic equivalent of auto assembler. Anyone with a home computer has had the experience of calling the manufacturer's phone support number and conferring with technicians who make roughly the wage of a skilled factory worker, and probably have a lot more fun. As the cyber-society becomes pervasive, there will be more such jobs. But contrary to the enthusiasts of training as the economic cure-all, it is unlikely that there will be enough of them.

And there remain the wide disparities in who gets to learn and use tools like Microsoft Art Gallery. Millions of homes are wired to the information highway. But precious few are in the inner city. Overwhelmingly, it is children of affluence, in prosperous school districts with supportive and available parents, who are using computers as instructional entertainment and playing SimCity in their spare time.

Educational computer games are indeed seductive and empowering for those with access to them. But for a child of the slums the available instrument of empowerment is more likely to be a handgun or a hit of crack. We have become a society in which the well-off can flick a switch and be entranced by a parallel universe where the opportunities are boundless and the only constraint is the number of spare hours in the day—while someone else is homeless on their doorstep.

Paul Starr's piece suggests that the very seductiveness of "edutainment" products like SimCity invites even children from deprived homes to join in the games. One can imagine a strategy of saving the next generation with a saturation dose of cyber-instruction in the schools, coupled with heroic job creation. One can also imagine income-redistribution schemes to offset the widening market inequalities, as well as new strategies of regulation to keep up with the changing technologies. But such a strategy demands public outlays. That in turn requires a politics somewhat out of harmony with the implicit values of the information age, for all the reasons noted above.

"Virtual communities"—far-flung affinity groups connected only by E-mail—may create surprising solidarities. But they are mainly private solidarities and seldom civic ones, and rarely the kind that support political interventions such as income redistribution and enhanced social spending. On the contrary, the political values that flourish at places like the Microsoft campus are just what a Douglas Coupland or a George Gilder might predict—a libertarian politics that is liberal on such issues as the environment, gay rights, privacy—but convinced that income reflects merit, and skeptical of taxes, social spending, and regulation. The fact that unions have failed to make even a toehold in Silicon Valley

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perfectly reflects the entrepreneurial, individualist-paternalist subculture. Coupland's lightly fictionalized and scathing picture of life at Microsoft, in the January issue of *Wired* magazine, was appropriately titled "Microserfs."

Still, the smartest commentators on technology and society, such as Shoshana Zuboff, and Charles Sable and Michael Piore, have resisted the sort of technological determinism that is the implicit worry of this essay. Though the information society may disguise political questions and make it harder to sustain a mixed economy, how we use the technology is still ultimately a political choice.

Recently, the Federal Communications Commission determined that local cable companies were using their monopoly power to overcharge consumers, The FCC ordered cuts in local cable charges, averaging seven percent. This, in turn, helped precipitate the collapse of the proposed merger of the cable giant TCI with Bell Atlantic, which had been predicated on continued windfall profits. The *Wall Street Journal* chastised the new FCC chairman, Reed Hundt, for failing to appreciate the sublime connection between monopoly cable profits and capital investment in the next wave of technology: "The Clinton FCC, faced with a...decisive [technological] moment, lurches to dilute an entire industry's cash flow."

However unintentionally, the *Journal* underscores the reality that the information age doesn't moot regulatory questions. It only poses them in new forms: How much money should cable monopolies be allowed to gouge from consumers? Should we excuse monopoly profits as necessary sources of investment? (Joseph Schumpeter would be pleased; Adam Smith would not.) How shall the available spectrum be allocated? How much market share should a Microsoft be allowed to corner before it is deemed a predatory monopoly? Is Windows an improper rip-off of Mac? Which innovations should be in the public domain? There is no intuitive "free market" solution.

The social policy questions don't go away either. Don't we benefit as a society by broadening the access to these new tools? How many more like Bill Gates might emerge if they had access to adequately funded schools? Would Gates really stop inventing software if society doubled the man's taxes in order help finance public education? It is not sufficient to wait for self-educated cyberpunks to stumble on the allure of the Net.

Nor do the issues of labor regulation posed by Rothstein disappear. If we want to stand by as our high-wage society converges with the world's most benighted ones, that too is a political choice. Knowledge will help, but training by itself won't stop a global wage race to the bottom. Even the presumed connection of income and merit, as Robert Frank suggests, cannot condone the actual income distribution that our imperfect market society creates. Some of Gates's fortune is the result of his brilliance and entrepreneurial zeal and the public's appetite for computers. Some of it reflects publicly subsidized education and R&D, as well as copyright, patent and antitrust laws which (so far) allow Microsoft to be a near-monopoly.

Thus the paradox: cyber-society offers equality of opportunity, but left alone it celebrates a new inequality of result based on market forces, privatism, and the distributive chasms of presumed merit. Whether that turns out to be the actual result depends on familiar, pre-cybernetic questions of regulation, distribution, and social investment. Contrary to Gilder, we do not—cannot—live in a Platonic economy of pure ideas. Few of us spend all our waking hours on-line. Turn off the computer and we still live in an unequal, material, fleshly world where millions of people are homeless or jobless. Cyberwealth doesn't change that. Indeed, our society is one in which we think twice about carrying the new computer home from the store, lest we get mugged. Whether that matters is also a political choice. ❖

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Health Care: Reformers' Rounds

Organizing Reform

James A. Morone

In the high drama of winning health reform, a crucial matter is being pushed aside—who is going to make the system work? The fate of health reform turns on effective, sensible administration. Ignoring the issue now will produce chaos when the reforms are implemented.

The president's Health Security Plan gives the administrative job to vaguely delineated regional health alliances. The plan leaves most organizing details to the states though it loads an eye-popping roster of tasks onto the alliances. The alliances oversee cost control, assure universal coverage, keep an eye on the quality of care, negotiate insurance contracts, collect premiums, and discipline insurers who



grab the easy money by chasing healthy people. They are the heart of the new health care system.

Conservatives respond with the Republican reflexive: too much government. They are exactly wrong. It is health care competition that creates the regulatory burden. Entrepreneurs in a dynamic market will restlessly seek out creative, winning strategies. In health care, the surest path to fortune is grabbing the healthier patients. The next best alternative is shifting your own costs to another payer.

Reforming the rules will not alter the entrepreneurial incentives, only prompt new calculations about how to achieve them. Someone—call them alliances or regulators or health boards—has to referee the complex health markets. Without careful monitoring, the new competition will yield the same old troubles: eroding coverage, rising costs, nervous citizens, cost shifting, chaos.

But if conservatives cannot have health markets without regulation, progressives must design agencies that are up to the job. The financial stakes will be enormous. Expect ferocious interest group politics.

Begin with the most rudimentary question of political design. To whom will the alliances be accountable? Answer: cross cutting political forces competing for influence over health policy. The states will each have to hash out their own laws, specifying the details and granting operating authority. Interests that lose in Washington can try again on their political home court. This time, those who can afford lawyers and lobbyists will most profit from the drafting of esoteric administrative details.

When the governors draw the alliance

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boundaries within their states, a new set of conflicts will erupt. In some cases, boundaries will affect reimbursement rates. In others, they will provoke long-standing local animosities. Expect years of litigation.

The last federal try at rational health policy through local agencies—the health planning program of the 1970s—signals the danger. Throughout the country, local communities plunged into the bare-knuckled politics of agency construction. In Philadelphia, for example, the suburbs sued for a separate agency to avoid being swallowed by the Philadelphia medical establishment. The powerful hospital union quickly jumped into the fray. So did local hospital associations, medical associations, the Rizzo administration, suburban leaders, the congressional delegation, the secretary of HEW, several business groups, Blue Cross, a grass roots citizen action group, and a civil rights organization—each with their own agenda. The brawl lasted more than three years. And the result was a hopelessly unwieldy organization—a governing board of more than 100 members, overlapping committees, chaotic by-laws. Nor was Philadelphia at all unique. In Los Angeles, an organizational meeting got so hot that the police had to intervene. Four years into the health planning program, only eight states had met federal requirements. And, all this when the stakes were far lower.

Federal officials do retain some oversight authority over the alliances, but not nearly enough. The blunt mechanisms at their disposal offer little effective control. Federal officials can withhold certification only so long. They can de-fund only so many recalcitrants. And for many state officials, picking a fight with the feds is a trusty route to local popularity.

Choosing board members is another notorious source of uproar. In the presidents plan, the governors specify the selection method, though one-half of the board must be "consumers." However, unless the representational details are far more carefully specified, calling for consumers is more a fantasy than a serious policy. "Consumers" is an almost inexhaustible category that ranges from abortion foes to the Hemlock society, from Latino groups to motorcycle clubs. Once the alliance boundaries are sorted out, expect a spectacular scramble for board seats. Scores of organizations will stake their claim. And though the Clinton plan offers some sensible advice about board selection and accountability, state officials are free to ignore it.

The staff is even more important than the board. The alliances will need genuinely talented men and women, but their recruitment efforts will face the usual barriers. Professionals will be leery of joining high-conflict agencies. During every budget crisis, the staff will be tagged "bloated bureaucracy" and cut. And the most talented people will swiftly be lured to high paying industry jobs where they will negotiate with former colleagues over matters such as reimbursement levels.

In short, while the complexity of a decentralized, proto-competitive plan magnifies the importance of good administration, Washington politics present twin dangers: Conservatives push to eviscerate the alliances altogether—all but ensuring that the new health competition will magnify the troubles of the old. And all political sides are drawn to the alluring prospect of just forgetting about administration and jousting over the headline issues like universal coverage and employer mandates.

For those who care how the reforms will actually work, the historical lessons are vivid: resist the temptation to weaken the infrastructure of the plan. Do not fob off administrative detail to the states or to the unspecified future. Design the alliances carefully. Worry now about organization, management, board selection, and staff recruitment. Organize tight oversight. Carefully, specify the stick and carrots of federal control.

This is the oldest lesson in American political reform, laid out clearly in *The Federalist Papers*: we ignore the administrative detail at the peril of our aspirations.

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Get Insurers Off the Case

Marcia Angell

Even the most complex plan for health care reform—which the Clinton plan may well be—can be reduced to the simple matter of what a doctor does for a patient and why. No health care system can work unless doctors and patients are generally satisfied with this fundamental transaction. The greatest weakness of the Clinton plan is its potential for adding to the difficulties of doctors trying to deliver good medical care to their patients.

Most doctors are now paid on a fee-for-service basis. The more services they perform, the more they are paid. Although the consequent incentive of doctors to overtreat is not the only cause of rapid inflation in health care costs, it is certainly one of them. Furthermore, the fees are skewed so that doctors are rewarded preferentially—and sometimes extravagantly—for doing expensive tests and procedures. Since medical decisions are seldom clear-cut, there is great latitude for doctors to exercise a bias in favor of high-technology medicine—a bias further encouraged by medical schools, the malpractice system, and public credence.

In recent years, third-party payers have reacted by attempting to reduce coverage in one way or another. For example, they often review doctors' decisions before agreeing to cover certain services or deny coverage for certain services after the fact. Such efforts to micromanage care are extremely frustrating for both doctors and patients. Doctors feel like double agents, torn between their patients' interests and restrictions imposed by third parties. Patients, for their part, feel that the care they receive is increasingly determined by conditions other than their medical needs or their doctor's judgment.

The Clinton approach, proponents hope, will reduce third-party micromanagement, in part by removing the incentives for doctors to perform too many services. Unfortunately, it would replace them with different incentives that may be even more harmful to doctors and patients. Most patients would receive their care from health plans, prepaid networks of providers analogous to HMOs. Since a plan would receive a set premium for each patient—"capitation"—no matter how many services were actually delivered, it would have an incentive to provide fewer services rather than more. Primary care doctors would function as gatekeepers, regulating access to the more expensive elements in the system, such as specialist consultations and hospitalization.

This reversal of incentives carries with it the risk that doctors might do too little, rather than too much. The Clintons propose to prevent undertreatment by requiring plans to compete for patients on the basis of quality as well as price. The playing field would be leveled by requiring all plans to offer at least the same basic package of services, and they would not be permitted to turn down an enrollee because of health status. Ostensibly, quality would be assured by permitting patients to switch plans each year if they were dissatisfied, and also by setting up an independent quality management program. But most people stay reasonably well in any given year, regardless of the quality of their medical care. Deficiencies in quality would therefore affect only a small fraction of enrollees and would be difficult to discern. Indeed, the great majority of enrollees might be satisfied relatively cheaply by plans that provided courteous and prompt attention in pleasant surroundings, while simultaneously stinting on more important elements of care, such as access to expensive imaging studies for the few who need them.

The threat to quality is exacerbated by the fact that most plans would be owned by profit-making businesses, notably the giant insurance companies. To maintain profit margins within a budget, these businesses

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would have a strong incentive to cut down on services. Since the doctors would be employees or contractors, the insurance companies would have even more control than they have now over the care doctors deliver to their patients. Efforts to monitor quality in the face of strong pressures to reduce it would require a large and inevitably clumsy public bureaucracy that would siphon off resources from the actual delivery of health care. Such a bureaucracy could well turn out to be as expensive and intrusive as the present one.

Two revisions to the Clinton plan would help. First, the plans should be owned not by profit-making businesses but by nonprofit cooperatives of doctors and enrollees. If this were the case, the interests of investors would not be pitted against the interests of doctors and patients. Second, price competition should not be permitted. Instead, the plans should be paid a fixed premium according to their patient mix. Plans would then compete explicitly on the basis of patient satisfaction and the incentive to undertreat would be greatly tempered. With these revisions, there would be little financial reason to provide either too much care or too little, and the need to monitor quality closely would be reduced.

Health care should be treated as a social good, not a market commodity. Although there is no way to remove financial incentives completely, we can reduce them. Doctors want to serve their patients well, as long as they are not subject to overwhelming inducements to do otherwise.

Keep Single Payer Alive

Rashi Fein

Since the debate on health care reform debate centers on the Clinton proposal, trying to improve that plan is more responsible than complaining that the president didn't choose the "single-payer" approach.

If some version of the Clinton plan is enacted, we need to maximize the likelihood that states will choose the single-payer option and that the plan will eventually evolve into a single-payer system overall. On the other hand, if Congress rejects the president's approach (say, by enacting incremental insurance reform and minor financing changes and merely promising to revisit universal coverage later), it will be important to have prepared the ground for a later debate.

How can advocates plant the seeds of a single-payer option within the Clinton framework? One idea is to add a Medicare option to the mix of health plans from which individuals can choose. This new Medicare option, perhaps called "Part C," could also enroll people in states that elect not to enter the program—a far more realistic fall-back option than the president's plan to put recalcitrant states into "receivership" and have the federal government develop alliances and plans for them. More important, the availability of a Medicare Part C option would stimulate the gradual development of an infrastructure for a single-payer financing mechanism. This new option would permit public insurance to compete with private insurance. Surely such competition should be welcomed by those who are aware of Medicare's performance compared with that of private insurance and should not be feared by those who claim that government is unable to do things efficiently.

Another worthwhile amendment would remove obstacles that make it nearly impossible for states to finance health insurance through broad-based state taxes or graduated premiums linked to income, instead of through employment-linked premiums. Though few states would probably opt for the single-payer tax alternative, the option to go that route would permit the gradual evolution toward a tax-

(continued on page 115)

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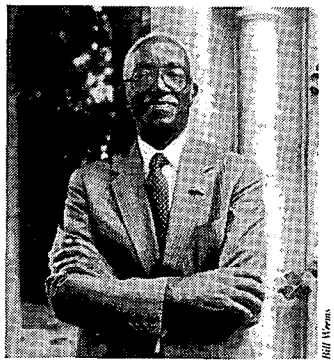
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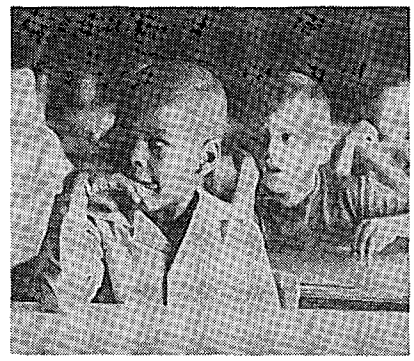
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Letters

Raising Keynes

To the Editors:

I find reading *TAP* both enjoyable and frustrating. The seriousness and substance of the contributions keep me reading. The high standards of language are a source of delight. What frustrates me is that a large part of your content seems irrelevant. For example, there seems to be no perception that the need for a healthy biosphere ipso facto places constraints on political and economic activity. To put it another way, the need for air to breathe is being disregarded in the discussion of activities that foul the air.

As for your last issue ("The Second Coming," Winter 1994), a man of Keynes's perception and creativity would not, I feel, be tearing around at the close of the century trying to bolster economic growth via increased consumption or to raise living standards, especially not in the industrialized West. Instead, he would endeavor to remedy inequities in these areas around the world. He would be addressing their shadow side—waste. He would be demanding the inclusion of societal and environmental costs in reckonings of productivity.

I imagine that Keynes might be devising theoretical frameworks that would help societies define and implement equitable concepts of economic sufficiency, technological appropriateness and sustainable use of resources. He would long ago have disowned the notion that buying and consuming stuff ad libitum can be a painless solution to anything. He would be proposing weightings in favor of quality over quantity. He would be embarking on an exhilarating quest exploring the possibilities and rewards, both societal and individual, of creative frugality.

If we allow the benighted to keep defining us, we shall all keep running around in circles in the dark. If we allow the past to define the scope of our imaginations we are sunk.

Kurt Volckmar
Garberville, CA

To the Editors:

In "Keynes, Einstein and Scientific Revolution" (Winter 1994), James K. Galbraith offers delicious insights on the role that Albert Einstein's theories played in shaping the thinking of John Maynard Keynes toward an all-encompassing theory of economics. He suggests that though Keynes fell short of his objective, his successors missed a good bet in not picking up this line of thinking and that economics is stuck in the old hat thinking of Isaac Newton. I have no quarrel with Galbraith's conclusions in regard to Keynes or his use of these analogies as a literary device or as agent provocateur. But any model from physics is unlikely to offer economics the leap forward Galbraith would like to see.

Physics and economics are very different fields. Physics is a subject of great internal consistency. It is also a subject of great beauty to its practitioners or even to careful readers of popularized versions. Though developed by humans, each with the vagaries and strengths that go with being human, physics is nonetheless a science of things. There is a stable, real, material world against which the ideas can be tested, retested, revised, revisited, rejected or in the end adopted with the

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confidence that admits them to the stock of accepted knowledge.

Economics involves things that people do: one on one, ten on ten or a hundred million on a hundred million. It is faced with the enormously complex task of dealing with shifting sand and predicting where that sand will go and what that sand will do. And it must somehow take account of the unpredictability of those troublesome people who will keep stirring the sand throughout the process. Opinion, difficult to validate, plays a strong role. The methods of physics simply won't work in such a situation. Economics needs a Newton, let alone an Einstein, in the sense that Newton made the breakthrough to first show how quantitative predictive physics could be done. If such a person comes along and finds the paths for economics, it seems unlikely to be a path which parallels physics, at least as we know physics today.

F. Dow Smith
Groton, New Hampshire

James K. Galbraith Replies:

F. Dow Smith's letter expresses my views exactly. The right role in economics for scientific metaphors, from physics, biology or anywhere else, is exegetical and heuristic, not prescriptive. Einstein illuminates Keynes, but does not control him. And a wider understanding of the role physics metaphors play in neoclassical economics should foster independence from them, not imitation whether witting, unwitting, or merely witless.

Forecasting or Fortune Telling?

To the Editors:

"Forecasting Follies" by Jay P. Greene (Fall 1993) implicitly raises questions about how we evaluate formulas for making predictions.

For example, at the end of the 19th century, it was predicted that in the 20th century the air in New York City would be polluted. It indeed is polluted, but does that mean the prediction was correct? The forecaster had actually predicted that smoke-belching locomotives would provide the basis for transportation in the city. He had not foreseen the automobile. Only by the most generous standards should that forecast be dubbed correct.

Consider, for instance, the Campbell model cited by Greene, which predicted that Clinton would win 61.7 percent of the electoral college vote, while Clinton actually received 68.8 percent. How should we judge the model? What if this model had predicted each of the 50 states incorrectly, but the errors luckily cancelled to give a result not far off?

It would therefore be of interest to know how many states the Campbell model did predict correctly. More generally, if an individual prediction is to be judged, its complete theory and implementation should be included, not just its output, which may, like a fortune teller's prophecy, be just a single number.

Sherman Stein
Davis, CA

Sherman Stein is professor of mathematics at the University of California at Davis.

Jay P. Greene Replies:

Sherman Stein's letter reinforces a point I was making: successful prediction of one election does not verify a forecasting model. Since there were only two realistic outcomes, Bush wins or Clinton wins, and more than 20 forecasting models, some of them were bound to pick the right outcome by chance alone.

Stein is also right to question whether models that predict the national result from the outcome in each state accurately forecast state races. Campbell's model, for example, comes reasonably close to predicting the national outcome from 1992, but it only correctly predicts the winner in 35 of the 51 state races (including D.C.). If we flipped a coin for each state race we would expect to get 25.5 right. For purposes of comparison, in an informal election pool among graduate stu-

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dents in the government department at Harvard University, contestants on average correctly predicted the winner in 41.2 state races. People interested in knowing the presidential election winner in advance might do as well talking to graduate students as consulting formal models.

Graphic Distortion

To the Editors:

Robert S. McIntyre, in "Journal of Graphic Fantasies" (Fall 1993), rightly takes the *Wall Street Journal* to task for using deceptive graphs. Unfortunately, he uses his own deceptive graphs to make his point.

First, the baseline of his vertical scale is not zero. This tends to exaggerate the distance between peaks and valleys in his data. With a scale starting at zero, the data line is neither the flat line implied by the *Journal*'s graph nor the jagged line implied by McIntyre's.

This is a common tool for misleading the audience. President Clinton used it during his address to the nation just before the congressional vote on the budget. His graph of the deficit had a vertical scale starting at $150 billion. Because of this, some viewers think that he will balance the budget in five years.

Second, the line between data points in the *Journal*'s graphs is much thicker than the corresponding line in McIntyre's graphs. This exaggerates the difference between the flat lines and the jagged lines.

Third, the dimensions of the graph in Figure One are 2 and 3/16 inches by 4 and 7/8 inches, while the dimensions of the graph in Figure Two are 2 and 1/2 by 4 and 1/8 This tends to stretch the graph vertically which, again, exaggerates the distance between the peaks and valleys.

Peter G. Stamoolis
Bethel Park, PA

Robert McIntyre Replies:

Peter G. Stamoolis chides me for three distortions in one of my graphs, but his criticisms are misplaced.

Stamoolis's chief argument is that all honest graphs must use zero as the baseline for the vertical axis. But that's not true if the purpose of a graph is to illustrate changes over time. For instance, if he were charting trends in average temperatures over the past several millennia, I can't believe he'd use absolute zero (-273 degrees Celsius) as his baseline. Nor would it make sense for him to alter his baseline depending on whether he was using a Celsius or Fahrenheit scale (0 degrees Fahrenheit equals -18 degrees Celsius). If average temperatures have varied between 40 degrees and 60 degrees, that would seem to me to be the appropriate scale to analyze trends.

Likewise, if we're trying to analyze whether tax collections have varied with tax rates over the past several decades, zero taxes isn't a relevant baseline. Rather we should focus on a reasonable range of values. To be sure, trivial differences shouldn't be exaggerated by scaling. But my graph that Stamoolis criticizes covers quite a wide range of tax revenues, equal to about 3 percent of the gross domestic product, or $175 billion in annual collections. Why should the scale go all the way down to zero percent of the gross domestic product when the lowest observed value is 17 percent of the GDP?

I agree with Stamoolis that the line in the *Journal* graph I replicated is extremely thick (and much thicker than the line in my graph). But that was the *Journal*'s attempt at subterfuge, not mine. Indeed, I hoped that readers would find the preposterous thickness of the *Journal*'s line as humorous as I did.

Stamoolis's final complaint is that my graph is a sixteenth of an inch taller than the *Journal* graph I compared it to. But my 61 percent height-to-width ratio is pretty common for a time series graph illustrating change. As for the *Journal*'s graph, well, obviously it's silly, but I replicated it as the *Journal* presented it.❖

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Seductions of Sim

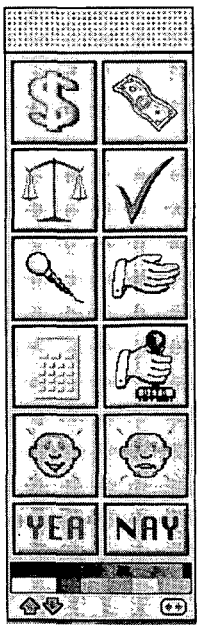
Policy as a Simulation Game

Paul Starr

Standing around the computer, my two older daughters, nine and eleven years old, scan the picture of the city we're creating and debate whether it needs more commercial or residential development. My six-year-old son suggests we look at the city budget. In just a few weeks he has learned enough to ask the critical question: "What's the cash flow?"

This is SimCity, one of a series of computer simulations that turn public policy and ideas into popular entertainment. With the advent of dramatically improved graphics and powerful, low-cost multimedia computers, a new generation of "edutainment" software has finally begun to fulfill the long-touted promise of computers in education. Most of the new programs use interactive multimedia to make games out of traditional subjects such as arithmetic or geography. In MathBlasters, for example, children solve math problems in order to fuel up a rocket and find a villain in outer space.

However, the Sim series, produced by California-based Maxis, goes a step further: it makes games out of simulations of complex natural and social systems, based on advanced and sometimes controversial areas of science and decision making, such as climatology and environmental science, genetics, and sociobiology. Those who think designing cities is prosaic can move on to simulating the development of planetary ecosystems (SimEarth) or the evolution of new life forms (SimLife). Other programs make games out of the management of railroads (A-Train),



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and farms (SimFarm), and even national health policy (SimHealth). These are unlikely ever to challenge Nintendo's Super-Mario World in sales. Still, it isn't only policy wonks who are buying the games for themselves and their kids. SimCity has sold two million copies since its release in 1989 and has probably introduced more people to urban planning than any book ever has.

When my family first began playing SimCity and others like it not long ago, my initial reaction was a mixture of excitement and skepticism. The new simulations are certainly a lot more fun than most textbooks. Rather than present information, they provide tools for inventing worlds, exploring hypotheses, and stretching imaginations. Several have a public viewpoint. In SimCity—unlike Monopoly—the player builds a community. One of the "scenarios" in the latest version of SimCity puts the player in Flint, Michigan in 1974 with the task of rebuilding the local job base and community. In SimEarth and SimLife, the object is to create sustainable environments and avoid extinctions.

But I worried whether the games might not be too seductive. What assumptions were buried in the underlying models? What was their "hidden curriculum"? Did a conservative or a liberal determine the response to changes in tax rates in SimCity? While playing SimCity with my eleven-year-old daughter, I railed against what I thought was a built-in bias of the program against mixed-use development. "It's just the way the game works," she said a bit impatiently.

My daughter's words seemed oddly familiar. A few months earlier someone had said virtually the same thing to me, but where? It suddenly flashed back: the earlier conversation had taken place while I was working at the White House on the development of the Clinton health plan. We were discussing the simulation model likely to be used by the Congressional Budget Office (CBO) to "score" proposals for health care reform. When I criticized one assumption, a colleague said to me, "Don't waste your breath," warning that it was hopeless to get CBO to change. Policy would have to adjust.

There are, of course, important differences between computer simulation games and the simulations used to assess policy options. The games are designed to be entertaining; fidelity to empirical reality is not foremost. But simplification is inherent in any simulation. Even "real" simulations (if that is not an oxymoron) inevitably rely on imperfect models and simplifying assumptions that the media, the public, and even policy makers themselves generally don't understand. Both types of simulation are examples of what might be called a *crossover intellectual technology*, one that has only recently moved from academic and technical fields into popular and public use. The crossover of simulation holds out the promise of an enriched understanding of the world, particularly of complex systems. But there is a danger too: forgetting that simulations depend on the models on which they are built.

The danger is particularly worrisome when simulations are used to make predictions and evaluate policies. And when policymakers depend on simulations to guide present choices—especially when legislators put government on "automatic pilot," binding policy to numerical indicators of projected trends—they cede power to those who define the models that generate the forecasts. This is happening in America today, most notably with the rise of the CBO as a power center in national policy. In a sense, Washington is already Sim city.

Original Sim

Although it has taken three decades for them to come of age, simulation games—and SimCity in particular—are really children of the '60s. Indeed, their development follows a classic pattern of our time. In their infancy, simulations and related advances in computer technology were nurtured by government grants for both military and domestic policy purposes. In

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their maturity, they are being turned by private initiative and investment into a phenomenon of popular culture.

To be sure, the genealogy of simulation can be traced back to a varied history preceding the 1960s. At least since their use by the Prussian army in the eighteenth century, simulations of combat have been a staple of military training. War games were, so to speak, the cradle of simulation. By the post-World War II era, engineers and corporate managers were using simulations to design and run power grids, telecommunications networks, factories, and businesses. Business simulations, which began primarily as training exercises, evolved into a routine management tool. And as researchers gained access to computers in the 1950s and '60s, simulations came into wide use for scientific purposes to understand complex systems such as climates, economies, ecosystems, and international relations.

As these examples suggest, simulations referred to at least two types of activity. One kind of simulation created a role-playing game and engaged participants in working out a scenario under prescribed conditions and rules. The other kind projected the behavior of a complex system on the basis of a quantitative model. The new computer simulations create games based on models of complex systems and, in that sense, they combine the two.

The forerunners of these games were developed in the 1960s. "Social simulation" took off during the '60s in several independent forms. At Johns Hopkins, the sociologist James S. Coleman and his colleagues worked on simulations as a means of both advancing social theory and improving education, particularly for minority youth. Role-playing simulations and games, they argued, would enliven the teaching of subjects as diverse as mathematics and social studies. One of the games, called Ghetto, sought to expose the logic of inner-city life. The hope was that as a tool of research, simulations and games would enable the theorist to define and grasp the underlying rules of social systems. (Economics, of all the social sciences, has most used games this way.) As a tool of school reform, simulations would provide a more accessible, participatory method of education for children who did not respond well to traditional instruction. John Dewey's educational ideals would finally be realized—or at least simulated.

When policymakers depend on simulations, they cede power to those who define the models. Washington is already Sim city.

Advanced training programs and consensus-building for professionals and decision makers also made increasing use of role-playing simulation games, sometimes involving large groups working under a trained facilitator. Some of the earliest games simulated urban conflicts over resource allocation. In 1964, one of the founders of the field, Richard Duke, designed a game called Metropolis for the city council in Lansing, Michigan. The game used role-playing to work through policy decisions and employed computers to track the effects, as the group went through one cycle of decision making after another. By the mid-1970s, a later version of the game, Metro-Apex, gave computer simulation a central role.

During the 1950s and 1960s, a variety of planners and social scientists concerned with urban problems had been developing large-scale computer models of cities to simulate and predict their development under varying policies. These models were first designed primarily for transportation and land-use planning. The federal highway program provided a major impetus. Modeling burgeoned in both academic and professional city-planning

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departments and displaced older traditions that conceived of planning as "architecture writ large."

Large-scale urban simulation models first caught the public eye through the work of an outsider to the field. In 1969, Jay W. Forrester, an electrical engineering professor at MIT with no background in urban research, published *Urban Dynamics*, a book purporting to disprove common intuitions about urban policy. Forrester's next work, *World Dynamics*, proposed a model for the entire planet. A group based at MIT and led by his protégés prepared the 1972 report *The Limits to Growth* sponsored by the Club of Rome, which claimed to show that the world was reaching the end of its ecological tether.

Because of their dramatic conclusions, Forrester and the Club of Rome report captured the public imagination, but the reception accorded their work by researchers and professionals was much cooler. Forrester's urban model was not based on empirical evidence and had no spatial dimension. According to Britton Harris, a leading exponent of modeling and emeritus professor of planning, transportation, and public policy at the University of Pennsylvania, Forrester's model had little influence on urban planning. The Club of Rome report did incorporate data and had real influence, though it too had no spatial dimension. From the vantage of the Club of Rome, the world consisted only of aggregates and averages. While undoubtedly contributing to public awareness of global environmental problems (and better subsequent research), the report itself has not withstood the passage of time. For example, nearly all the resources that it predicted would be in short supply at escalating prices in the 1990s now have larger known reserves and are available at lower prices than they were in 1972.

Professional disillusionment with large-scale models was already setting in at the time of the Club of Rome report. In 1973, a leading journal in urban planning published a "requiem" for large-scale models. The emerging consensus was that the models had overreached; both the theory underlying the models and the available data were inadequate to make the kind of predictions the modelers were attempting. The modelers' "loss of faith," as one of the leading urban modelers, William Alonso, calls it, became part of a broader collapse of confidence in planning in the 1970s and 1980s. In the same era, efforts to apply simulation and games to the education of minority youth were also proving a disappointment. Critics questioned whether the educational payoff was worth the effort.

But while social simulation flagged, work on simulation models and games did not actually disappear. Rather, it retreated into more specialized circles. Role-playing simulations have become a standard technique for professional training and conflict resolution. During the next two decades, the development of computers, software, and data resources transformed both the scientific and popular potential of computer simulation. By the late 1980s, there was talk of a "renaissance" of large-scale models in urban planning, even though many in the field are still as wary as ever about the models' predictive powers.

The spread of desktop computers and advance of visualization techniques have been particularly important for the revival and popular crossover of simulation. Early computer simulations and games required access to mainframe computers and skills that were, to most people, esoteric. Improved graphics made simulations and games not only more accessible and absorbing, but also more "playable."

Much of the research behind advances in computer graphics was originally sponsored by the Department of Defense and space programs and grew out of work on flight simulation, which in the 1960s and '70s was centered at the University of Utah. The defense and space programs had a similar catalytic role in the development of the Internet. Virtual reality has followed the

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same route.

Improved graphics hit the home market with the growth of video games and the advent of the Macintosh. Even flight simulation has crossed over to become home entertainment.

It was while working on a video game for bombing islands that Will Wright, a Macintosh programmer, came up with the idea for SimCity. Wright told me recently that while designing a "terrain editor" to create the landscape, he discovered that he had "more fun building the islands than bombing them."

Wright had never studied urban planning—his background was in robotics and computer games—but on his own he found his way to the planning literature, including Forrester and Jane Jacobs. The subject became interesting to him only after he began simulating urban development. (Many people who have since played SimCity have probably had the same experience.) Drawing on research begun decades earlier, Wright fashioned the models of land use, traffic, power systems, and other aspects of urban development that underlie SimCity. He says he conceived of SimCity not as a game but rather as a "toy" because at least in its standard use there is no preset goal or contest. The player decides what kind of city to build—whether to emphasize its size, wealth, beauty, or harmony with the environment. In 1987, unable to find a software publisher who thought there was a market for such a toy, Wright joined with a businessman, Jeff Braun, to start Maxis and develop SimCity. The company now has more than 20 titles on the market and has spun off a separate firm to create business and public policy applications.

Inside SimCity

The seductive power of computer simulation games lies partly in their extraordinary variety and intricacy. Generating complex variation is one thing that computers do especially well. But interest in such games was limited as long as the "user interface" was text. Adding stereo sound and three-dimensional graphics enables people to handle greater complexity at a faster pace. This is what makes multimedia simulation such a powerful communication medium. SimCity shows why.

Like several other programs in the Sim series, SimCity offers a choice between two types of play: building a system from scratch or solving the problems in a specific scenario. (All references here are to SimCity 2000, the more elaborate, three-dimensional version of the game released in 1993.) The player who builds a city de novo receives a starting fund and a randomly generated, five-square-mile terrain whose features can be chosen and modified at no cost prior to the start of play. For example, the player can decide whether to locate the city on a coast or river and how much area will be covered by water, hills, and forests. The terrain will be different every time. Once play begins, the development of the city is open-ended, with no fixed objectives or time limits, except as the player defines them. In contrast, in the second type of play, the player loads a scenario with a given map and limited time to accomplish a specific task, such as revitalizing Flint, rebuilding Charleston, South Carolina after a hurricane, or turning "Dullsville, U.S.A.," into an exciting community.

As mayor of SimCity, the player has extraordinary powers; there is no city council, state government, or public employee union to worry about. (Weep, Rudolph Giuliani, weep.) The mayor can set local tax rates and locate and build various community facilities and services, such as power plants, water systems, roads, highways, rails, airports, police and fire stations, schools, and hospitals. The mayor can also control annual spending on city services, adopt ordinances on matters ranging from pollution control to the promotion of tourism, and zone areas for industrial, commercial, or residential use.

SimCity operates on a "field of dreams" principle. If as mayor the player creates the right environment, the Sims—the imaginary inhabitants of the city—will come and

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build factories, shops, and homes. When they do, buildings and factories pop up on the land and change as the city develops. But if things turn sour—if unemployment rises or high crime rates in a neighborhood drive people away—the icons on the screen change or go dark to indicate population losses or building abandonment. All this takes place in vaguely historical time (the player can set the starting data at 1900, 1950, 2000, or 2050), which primarily affects the available technology and rate of energy consumption.

To help make decisions about zoning, taxes, expenditures, bond issues, and other policies, the program provides a wealth of constantly changing data in maps and graphs showing the city's population growth and density, demand for residential, commercial, and industrial land, unemployment, power and water supply, crime, traffic congestion, pollution, and various other aspects of the city's development. The same sources report changes in interest rates and the growth of the national economy and neighboring cities. Newspapers periodically deliver reports of local sentiment, including the latest public opinion polls and inane, jumbled stories about local and made-up international events. A hallmark of the Sim games is a light touch. (My favorite example: In SimAnt, which translates the sociobiology of ant behavior into game form, one ant curses a group from another colony, "Your queen mates with termites.")

The key to SimCity is the interaction of private land values with the public budget. As the player constructs a city, the value of property zoned for development is continually changing. These changing values are critical, for they affect property tax receipts and determine—as my six-year-old quickly discovered—whether the cash flow in the city budget is positive or negative and therefore whether the player has to raise taxes, cut spending on city services, and skimp on public investments.

Will Wright aptly refers to the basic conceptual framework of SimCity as a "capitalistic land value ecology" and argues that it fits the development of American cities in the twentieth century but would not account for the development, for example, of St. Petersburg. In fact, SimCity is somewhat more constraining; the game seems to require a particular type of American city built on an industrial base.

The model in SimCity, as Wright describes it, consists of a series of "concentric rings." At the core is a so-called "basic/nonbasic" or "export/import" model, borrowed from the traditional urban development literature, that describes the evolving relationship of the industrial, commercial, and residential sectors. SimCity assumes that while 70 percent of industrial production is exported outside of a city, 70 percent of commercial production is consumed internally. Thus in the early stages of a city's development, while its internal market is small, the industrial sector must predominate. As the city and its internal market grow, commerce begins to expand, ultimately overtaking industry as the main source of employment. The demand for residential space depends on the growth of other sectors. If jobs outnumber potential participants in the labor force, people will move to the city and demand for residential development will increase. If the local economy is doing badly and there are fewer jobs than workers, unemployment will rise and people will leave the city.

According to Wright, SimCity uses a "bid rent" model to determine land valuations. Property carries different values depending on its use; for example, proximity to the urban center is valued most for commercial and residential purposes and least for industry. The actual numbers used in SimCity for land values, city investments, and other items bear no relation to the real world. However, the overall valuation of SimCity and thus its tax base will depend on how the player distributes and locates different zones and allocates resources among roads, schools,

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and other public services.

Wright says SimCity is built "from the inside out." In the outer rings are models for traffic, energy, water, and other systems, which react back upon and modify the land-use model at the core. The hardest problem, according to Wright, is not what to put in but what to leave out. He is disarming about the game's limits. Inevitably, SimCity is a "caricature" of reality. The models deliberately exaggerate effects to provide feedback to the player; in real life, the effects of many decisions would be imperceptible. The purpose of SimCity is not accuracy or prediction but communication. "Unless it's entertaining, the educational value is irrelevant." Asked how he handles controversial choices, like the effects of tax rates on development, Wright dodges the question and says, "We go for game play"—whatever is most fun.

Still, when players make decisions in SimCity, the game generates effects on employment, crime, population growth, tax revenues. I would be more worried about too easy an acceptance of the validity of those effects if SimCity worked with real data. Games of that kind may well be on the market not long from now, enabling players to download real maps and data into a game with a visual interface like SimCity. But, as now designed, SimCity is clearly a fictional world and the effects seem only as real as points scored in a video game. This is even true of the Flint scenario because of the patently fictional quality of all the numbers used in the game.

SimCity's players learn not from any particular aspect of the model but from the process of being forced to make choices and face the consequences. Most immediately, they confront choices of spatial design in distributing land among potential uses and locating community resources like schools and NIMBY's like power plants. These choices have a temporal as well as spatial dimension. Players who overinvest too early in costly capital projects like an airport or stadium will quickly find themselves in fiscal trouble.

The important payoff comes from struggling to master complexity. Wright observes, "Playing the game is the process of discovering how the model works." Of course, few players will be able to give any formal expression to the model. But much of it is implicit in the manual that comes with the game, and many players will be able to figure out critical relationships from the signals that the game provides. To keep up with a city's changing size and demands, the game requires constant monitoring of the city's power, water, transportation, budget, and other systems.

If there is a "hidden curriculum" in SimCity and other Sim games, it lies here. Shoshana Zuboff's 1988 book *In the Age of the Smart Machine* describes the confusion and alienation of workers in factories and offices as computers were first introduced over the previous decade. Physical contact with the production process had been an important source of practical knowledge; for example, workers at pulp mills that Zuboff studied had been able to tell whether anything was wrong merely from the color and odor of the pulp. Now the workers were asked to make decisions based on information flashing on a computer screen. This shift deemphasized sensory knowledge and put a premium on more abstract, "intellective" capacities. This is exactly what SimCity teaches: the management of complex systems based on "intelligent scanning" of streams of constantly changing information.

As SimCity has evolved, it has incorporated increasing levels of complexity. For example, in the original SimCity, the fiscal options were limited. There was one tax rate that players could raise or lower, no possibility of floating bonds, and just three types of operating expenditure—transportation, police, and fire protection. In SimCity 2000, the player can vary property tax rates by class (residential, commercial, industrial); offer tax incentives to specific industries; impose a sales or income tax; borrow funds; refinance bonds; budget a wider

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variety of programs now including education, health, and welfare; and vary expenditures within each budget category (for example, primary and secondary schools versus higher education) and even by neighborhood.

This degree of complexity may seem astonishing in a game for children. But when children play SuperMario World and other popular adventure games, they must learn the most intricate facts about the many imaginary places they navigate. These worlds are typically filled with strange creatures, hidden passageways, and special treasures. Going from one level of the game to the next demands an extraordinary mastery of detail. Compared with these demands, managing SimCity is surprisingly straightforward.

SimCity makes complexity manageable partly by enabling players to ignore much of it when they are first learning the game. For example, players can turn on "auto-budget" and let the program follow its default options until they are ready to take up fiscal alternatives. When they do, they will find that SimCity allows the mayor to get advice from various city council members—or are they consultants?—who appear at the click of a mouse. Their recommendations may not, however, always be consistent. As I was playing, one adviser urged me to raise taxes to cut the city's deficit, while another said I should cut taxes to stimulate growth. This difference seemed to me a truly real-world touch.

SimCity teaches the management of complex systems based on streams of constantly changing information.

Wright says that the next stage in SimCity's development may enable the player to dive into a city to run a business inside it. He also wants to give players the ability to modify the model's assumptions. "We want the user to be able to define more and more of the model." Ultimately, he says, the game could allow players to build the models themselves. Whether many people would use this opportunity is unclear. But the option would permit mastery of a simulation in the more fundamental sense of being able to manipulate the assumptions and relationships behind it. In its current version, the model is an unreachable black box. A new Sim game, SimHealth, does allow players to modify assumptions and define the governing values. But in practice, SimHealth shows some of the limitations of the genre.

A Simulation Muddle

The premise of SimHealth is that you have been elected to Congress in 1992 and seek to get reelected by choosing policies for health care. The game and the voters then rate your performance not against an independent standard but rather against your own—the values you have selected at the outset. This is an attractive concept. However, the framework for "clarifying" values adopted by SimHealth is based on hackneyed and misleading premises. SimHealth asks players to define their values in terms of two dualities—liberty and equality, and community and efficiency—on the premise that more of one value in a pair necessarily means less of the other.

But is this the case? Historically, many societies that have denied basic liberties have also had extreme inequalities. When we talk about rights, we generally mean equal rights; thus the two concepts overlap, often reinforcing one another. For example, does the right to assemble peaceably for redress of grievances express the value of liberty or equality? What about equal educational opportunity? Compared to the U.S. system today, is Canadian-style national health insurance an expression of equality (since everyone is covered) or of

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liberty (since all are guaranteed individual choice of physician and no one suffers from job lock)?

To assume a zero-sum relation between liberty and equality, and community and efficiency, obscures a central challenge of policy—how to achieve progress on more than one value at a time. For example, few would disagree that by eliminating administrative sources of inefficiency, we are better able to carry out aims benefiting the community as a whole. But in SimHealth, efficiency and community are counterposed. Perhaps even more fundamental, SimHealth's framework fails to appreciate that the main political differences in health policy, as in other areas of American politics, concern conflicting interpretations of widely shared values. Those who take different positions do not necessarily differ in the value they place, for example, on liberty; they often disagree about what liberty means in relation to health care (freedom to change jobs without fear of losing coverage, freedom to pick a health plan, freedom to pick a doctor, freedom to consult alternative healers, and so on).

SimHealth's philosophical muddle is inadvertently apparent from the arbitrary connections it asserts between values and particular statements that are supposed to embody them. The value of community supposedly calls for "restructur[ing] health insurance to provide the highest quality care." But it is obscure to me why "community" should mean an emphasis on quality of care rather than, say, careful stewardship of resources, priority for public health measures, or universal coverage.

SimHealth does no better a job of explaining health care policies and proposals. Indeed, the game is littered with crude simplifications and outright errors of fact. It mixes up the concepts of managed care and managed competition, confuses an individual's share of premiums with the coinsurance rate (the individuals' share of payments for covered services), and misstates the basic arrangements proposed in the Clinton and other proposed health plans in Congress. The effects of particular policies on public opinion seemed entirely arbitrary and capricious. I did not detect any particular political bias. But SimHealth contains so much misinformation that no one could possibly understand competing proposals and policies, much less evaluate them, on the basis of the program. And although SimHealth enables users to modify some assumptions, the model is never clearly explained and the basic architecture is beyond reach.

The oversimplified values framework and misinformation in SimHealth could be fixed, but the bigger problem is false pretensions. Unlike the plainly fictional SimCity, SimHealth claims to simulate the effects of different real-world proposals, which it cannot do. I suspect that if SimCity purported to help evaluate policies toward the homeless, it would seem equally inadequate.

SimHealth is a case of overshoot. The Sim games generally achieve their impact by engaging players in concrete tasks. SimHealth, however, seeks to engage players in formulating policy, which is entirely different. A child can start playing SimCity without any conceptual understanding of urban development. But to choose among various policy options in SimHealth, the player needs to understand their relation to one another. The conceptual threshold is too high, and it is not clear that a game can overcome it. On the other hand, for those who are familiar with the elements of health policy, playing SimHealth quickly becomes repetitive; it lacks the complex variation and intricacy of SimCity and other Sim games. Once the novelty of making health policy into a game has worn off, I doubt SimHealth will hold much interest. It certainly has no value in assessing health care reform.

Simulation in Reality

The critical problem raised by simulation is the black-box nature of the models. In the "real world" of policy simulation, the models are subject to criticism and debate,

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at least among professionals. Opposing sides in policy disputes often come armed with their own simulations, ready to fight numbers with numbers. However outrageously biased some of these may be, there is nothing remarkable or offensive about the practice—it is simply one aspect of today's pursuit of politics by other means.

The troubling questions, in my view, concern the use of simulation as an element of statecraft. In principle, models used for official purposes are more open to scrutiny than are those in the private sector, and that is enormously important. Within and across the branches of the federal government, the validity of the models and assumptions is subject to intense scrutiny, and a strong sense of professionalism limits political manipulation. However, to most participants in policy debates as well as the public at large, the models are opaque. Only a few can penetrate the black box and understand what is inside. This has two opposite effects. At a conscious level, many people are distrustful of official projections, like much else about government. In practice, however, the numbers take on immense importance. As a result, those who have technical authority over the black boxes acquire an extraordinary degree of influence in the political process. And technical authority matters because the outcome of simulations often depends on what is assumed in the first place.

The critical problem raised by simulation is the black-box nature of the models.

There is no obvious remedy to the black-box problem, and it affects conservatives as much as liberals. Conservatives who are wary of planning still depend on large-scale models for budgetary projections. Indeed, the most recent version of the balanced-budget amendment would require Congress to balance not actual outlays and receipts but projections of future streams. Since those projections would be produced through computer simulations, the amendment would give unprecedented authority to whoever served as official simulator—a role that sounds like the modern equivalent of court magician, and perhaps is.

The official simulator today, CBO director Robert Reischauer, may now be as powerful a figure as any member of Congress. The CBO has no veto over legislation, but it has a power that is nearly as great—the power to "score" legislation to determine compliance with budget rules and future effects on the deficit. When someone in Washington today claims savings for a proposed change in national policy, people ask not whether the savings are real but rather, "Are they scoreable?" This aspect of national policy has all the features of a game with arcane rules and assumptions. (One of the staff economists at the Council of Economic Advisers joked last year that after leaving he would write a kiss-and-tell book called *How to Score in Washington*.)

From the formative stages of policy-making, the effects are substantial. For the past several years, the CBO has cast a broad shadow over the debate about health care reform. Among the cognoscenti, cost-containment proposals have been classified in two ways—"scoreable" and "unscoreable"—depending on whether the CBO was likely to smile or frown. The prospect that the CBO would frown on a policy and deem it "unscoreable" has been a grave, sometimes fatal strike against it.

When the CBO finally made its report on the Clinton health plan, it was front-page news, and again the black-box problem was apparent. Now it was time to hear the score, though few understood what went into it. The president's critics heralded Reischauer for saying that premiums paid to health alliances should be counted in federal receipts (albeit as an "off-budget" item) and

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that the plan would raise the federal deficit by $70 billion in the years prior to 2004 before reducing it. It almost did not matter that the CBO estimated a near-term increase in the federal deficit in part because it projected larger savings to state and local government (indeed, recapturing those savings for the Treasury would make the plan virtually budget-neutral). Nor did conservatives who were praising Reischauer seem to appreciate the implications of CBO's general view of cost containment. While casting a skeptical eye on the market-oriented measures generally favored by conservatives, CBO has endorsed the effectiveness of regulatory measures that conservatives dislike. CBO accepted the Clinton premium caps as 100 percent effective. It has favorably assessed the impact of single-payer plans, particularly on administrative costs. This is by no means to say that CBO's judgments will be decisive, only that they have come to hold unprecedented influence.

CBO has emerged as a power center as the influence of Congress has grown relative to the executive branch over the past two decades. But CBO has also become a force in its own right, apart from the Congress, because of the predominance and persistence of budgetary issues in national politics and the search by the Congress to find ways to bind itself, like Ulysses to the mast, to resist strong impulses within. The official simulator is now called upon to provide not just clairvoyance but collective self-discipline. The discipline will hold only if the simulations do—only if there is one authoritative mechanism for defining the future in the present. The power of CBO has become an institutional necessity.

In the wider world, there is no comparable imperative to find a single mechanism for simulating alternative policies and theories. If there must be black boxes, at least we should have many of them to discourage faith in any one. Even better, we need to open up the boxes by making the models more transparent.

Transparency ought to become both the objective of simulation designers and a critical basis for judging their success. Richard Duke—the pioneer who first introduced computers into urban simulation games in the 1960s—is now deeply skeptical about models embedded in computers that oblige the user simply to accept an outcome as valid. Currently a professor at the University of Michigan and president of the International Simulation and Gaming Association, Duke says, "If a simulation hides the model, it's of little interest to me. If a simulation exposes the model, I'm much more interested." His own work now emphasizes role-playing policy simulation exercises that allow different players to engage each other, not just a black-box model. Besides allowing participants to practice skills in negotiation and group problem solving, the role-playing approach is much less deterministic: it introduces an unpredictable element of human choice into simulation games.

Computer simulation games with many simultaneous players linked through the Internet may also introduce more unpredictability. Moreover, as computer games become more elaborate and widely used, their sheer multiplication and increasing plasticity may promote a healthy skepticism about their predictive power. Playing with simulation is one way to see its limits as well as its possibilities.

For better or worse, simulation is no mere fad. Indeed, to think of simulation games as mere entertainment or even as teaching tools is to underestimate them. They represent a major addition to the intellectual repertoire that will increasingly shape how we communicate ideas and think through problems. The advent of this new medium has escaped the attention of cultural critics because it has come in the form of children's games. But the computer simulation game is an art form; when combined with three-dimensional graphics and sound, it is an extraordinarily powerful one. We shall be working and thinking in SimCity for a long time.❖

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Wild Pitch

'Three Strikes, You're Out' And Other Bad Calls on Crime

Jerome H. Skolnick

According to the pundits, the polls, and the politicians, violent crime is now America's number one problem. If the problem were properly defined and the lessons of past efforts were fully absorbed, this could be an opportunity to set national crime policy on a positive course. Instead, it is a dangerous moment. Intuition is driving the country toward desperate and ineffectual responses that will drive up prison costs, divert tax dollars from other vital purposes, and leave the public as insecure and dissatisfied as ever.

The pressures pushing federal and state politicians to vie for the distinction of being toughest on crime do not come only from apprehensive voters and the tabloid press. Some of the leading organs of elite opinion, notably the *Wall Street Journal*, have celebrated gut-level, impulsive reactions. In one *Journal* column ("Crime Solution: Lock 'em Up"), Ben J. Wattenberg writes that criminologists don't know what works. What works is what everyone intuitively knows: "A thug in prison cannot shoot your sister." In another *Journal* column ("The People Want Revenge"), the conservative intellectual Paul Johnson argues that government is failing ordinary people by ignoring their retributive wishes. Ordinary people, he writes, want neither to understand criminals nor to reform them. "They want them punished as severely and cheaply as possible."

Johnson is partly right and mostly wrong. Ordinary people want more than anything to walk the streets safely and to protect their families and their homes. Intuitively, like Wattenberg, many believe that more prisons and longer sentences offer safety along with punishment. But, especially in dealing with crime, intuition isn't always a sound basis for judgment.

The United States already has the highest rate of imprisonment of any major nation. The prisons have expanded enormously in recent years in part because of get-tough measures sending low-level drug offenders to jail. Intuitions were wrong: the available evidence does not suggest that imprisoning those offenders has made the public safer.

The current symbol of the intuitive lock-'em-up response is "three strikes and you're out"—life sentences for criminals convicted of three violent or serious felonies. The catchy slogan appears to have mesmerized politicians from one coast to the other and across party lines. Three-strikes fever began in the fall of 1993 in the wake of the intense media coverage of the abduction and murder of a 12-year-old California girl, Polly Klaas, who was the victim, according to

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police, of a criminal with a long and violent record. California's Republican Governor Pete Wilson took up the call for three strikes, and on March 7 the California legislature overwhelmingly approved the proposal. Even New York Governor Mario Cuomo endorsed a three strikes measure. The U.S. Senate has passed a crime bill that adopts three strikes as well as a major expansion of the federal role in financing state prisons and stiffening state sentencing policy. In his 1994 State of the Union address, President Clinton singled out the Senate legislation and three strikes for praise.

But will three strikes work? Teenagers and young men in their twenties commit the vast majority of violent offenses. The National Youth Survey, conducted by Colorado criminologist Delbert S. Elliott, found that serious violent offenses (aggravated assault, rape, and robbery involving some injury or weapon) peak at age 17. The rate is half as much at age 24 and declines significantly as offenders mature into their thirties.

If we impose life sentences on serious violent offenders on their third conviction—after they have served two sentences—we will generally do so in the twilight of their criminal careers. Three-strikes laws will eventually fill our prisons with geriatric offenders, whose care will be increasingly expensive when their propensities to commit crime are at the lowest.

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Take the case of "Albert," described in the *New York Times* not long ago by Mimi Silbert, president of the Delancey Street Foundation in San Francisco. At age 10, Albert was the youngest member of a barrio gang. By the time he was sent to San Quentin at the age of 19, he had committed 27 armed robberies and fathered two children. Now 36, he is a plumber and substitute teacher who has for years been crime-free, drug-free, and violence-free. According to Silbert, the Delancey Street program has turned around the lives of more than 10,000 Alberts in the past 23 years.

To imprison the Alberts of the world for life makes sense if the purpose is retribution. But if life imprisonment is supposed to increase public safety, we will be disappointed with the results. To achieve that purpose, we need to focus on preventing violent crimes committed by high-risk youths. That is where the real problem lies.

The best that can be said of some three-strikes proposals is that they would be drawn so narrowly that they would have little effect. The impact depends on which felonies count as strikes. Richard H. Girgenti, director of the New York State Division of Criminal Justice Services, says that the measure supported by Governor Cuomo would affect only 300 people a year and be coupled with the release of nonviolent prisoners. President Clinton is also supporting a version of three strikes that is more narrowly drawn than California's. Proposals like California's, however, will result in incarcerating thousands of convicts into middle and old age.

Regressing to the Mean

Before Governor Wilson signed the most draconian of the three-strikes bill introduced in the legislature, district attorneys across the state assailed the measure, arguing that it would clog courts, cost too much money, and result in disproportionate sentences for nonviolent offenders. So potent is the political crime panic in California that the pleas of the prosecutors were rebuffed.

The prospect in California is ominous. Even without three-strikes legislation, California is already the nation's biggest jailer, with one out of eight American prisoners occupying its cells. During the past 16 years, its prison population has grown 600 percent, while violent crime in the state has increased 40 percent. As Franklin E. Zimring and Gordon Hawkins demonstrate in a recent issue of the *British Journal of Criminology*, correctional growth in California was "in a class by itself" during the 1980s. The three next largest state prison systems (New York, Texas, and Florida) experienced half the growth of California, and western European systems about a quarter.

To pay for a five-fold increase in the corrections budget since 1980, Californians have had to sacrifice other services. Education especially has suffered. Ten years ago, California devoted 14 percent of its state budget to higher education and 4 percent to prisons. Today it devotes 9 percent to both.

The balance is now expected to shift sharply in favor of prisons. To pay for three strikes, California expects to spend $10.5 billion by the year 2001. The California Department of Corrections has estimated that three strikes will require the state to add 20 more prisons to the existing 28 and the 12 already on the drawing board. By 2001, there will be 109,000 more prisoners behind bars serving life sentences. A total of 275,621 more people are expected to be imprisoned over the next 30 years—the equivalent of building an electric fence around the city of Anaheim. By the year 2027 the cost of housing extra inmates is projected to hit $5.7 billion a year.

But will California be better off in 2027—indeed, will it have less crime—if it has 20 more prisons for aging offenders instead of 20 more college campuses for the young?

Of course, Wilson and other politicians are worrying about the next elections, not the next century. By the time the twice-convicted get out of prison, commit a third major offense, and are convicted and sentenced to life terms, Wilson and the others supporting three strikes will be out—that is,

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out of office, leaving future generations a legacy of an ineffectual and costly crime policy. To avoid that result, political leaders need to stop trying to out-tough one another and start trying to out-reason each other.

The Limits of Intuition

H.L.A. Hart, the noted legal philosopher, once observed that the Enlightenment made the form and severity of punishment "a matter to be *thought* about, to be *reasoned* about, and *argued*, and not merely a matter to be left to feelings and sentiment." Those aspirations ought still to be our guide.

The current push to enact three strikes proposals is reminiscent of the movement in the 1970s to enact mandatory sentencing laws, another effort to get tough, reduce judicial discretion, and appease the public furies. But mandatory sentencing has not yielded any discernible reduction in crime. Indeed, the result has been mainly to shift discretionary decision-making upstream in the criminal justice system since the laws have continued to allow great latitude in bringing charges and plea bargaining.

Ironically, mandatory sentencing allowed the serial freedom of Richard Allen Davis, the accused murderer of Polly Klaas. Before 1977, California had a system of indeterminate prison sentencing for felony offenders. For such felonies as second-degree murder, robbery, rape, and kidnapping, a convict might receive a sentence of 1 to 25 years, or even one year to life. The objective was to tailor sentences to behavior, to confine the most dangerous convicts longer, and to provide incentives for self-improvement. However, in 1977, declaring that the goal of imprisonment was punishment rather than rehabilitation, the state adopted supposedly tougher mandatory sentences. Richard Allen Davis benefited from two mandated sentence reductions, despite the prescient pre-sentencing report of a county probation officer who warned of Davis's "accelerating potential for violence" after his second major conviction. Under indeterminate sentencing, someone with Davis's personality and criminal history would likely have been imprisoned far longer than the mandated six years for his first set of offenses.

Most criminologists and policy analysts do not support the reliance on expanded prisons and the rigidities of habitual offender laws. Some, like David Rothman, have apologized for their naiveté joining the movement to establish determinate sentencing in the 1970s and now recognize that it has been a failure.

Others, like John J. DiIulio, Jr., take a harder line, although the hardness of DiIulio's line seems to depend on his forum. In a January 1994 column appearing—where else?—in the *Wall Street Journal*, DiIulio supported the superficially toughest provisions of the Senate crime bill. (The *Journal*'s headline writers called the column "Let 'em Rot," a title that DiIulio later protested, though his own text was scarcely less draconian.) But writing in *The American Prospect* in the fall of 1990 ("Getting Prisons Straight") and with Anne Morrison Piehl in the fall of 1991 for the *Brookings Review*, DiIulio's message was more tempered.

The Brookings article reviews the debate over the cost-effectiveness of prisons. Imprisonment costs between $20,000 to $50,000 per prisoner per year. But is that price worth the benefit of limiting the crimes that could have been committed by prisoners if they were on the street? "Based on existing statistical evidence," DiIulio and Piehl, "the relationship between crime rates and imprisonment is ambiguous." This is hardly a mandate for "letting 'em rot." DiIulio and Piehl recognize that the certainty of punishment is more effective than the length and that "even if we find that 'prison pays' at the margin, it would not mean that every convicted criminal deserves prison; it would not mean that it is cost effective to imprison every convicted felon." I agree and so do most criminologists. Does DiIulio read DiIulio?

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The Rise of Imprisonment

Two trends are responsible for the increase in imprisonment. First, the courts are imposing longer sentences for such nonviolent felonies as larceny, theft, and motor vehicle theft. In 1992 these accounted for 65.9 percent of crime in America, according to the Federal Bureau of Investigation's Uniform Crime Reports.

Second, drugs have become the driving force of crime. More than half of all violent offenders are under the influence of alcohol or drugs (most often alcohol) when they commit their crimes. The National Institute of Justice has shown that in 23 American cities, the percentage of arrested and booked males testing positive for any of ten illegal drugs ranged from a low of 48 percent in Omaha to 79 percent in Philadelphia. The median cities, Fort Lauderdale and Miami, checked out at 62 percent.

There has been an explosion of arrests and convictions and increasingly longer sentences for possessing and selling drugs. A Justice Department study, completed last summer but withheld from the public until February this year, found that of the 90,000 federal prison inmates, one-fifth are low-level drug offenders with no current or prior violence or previous prison time. They are jamming the prisons.

The federal prison population, through mandated and determinate sentences, has tripled in the past decade. Under current policy, it will rise by 50 percent by the century's turn, with drug offenders accounting for 60 percent of the additional prisoners. Three-strikes legislation will doubtless solidify our already singular position as the top jailer of the civilized world.

The Fear Factor

The lock-'em-up approach plays to people's fear of crime, which is rising, while actual crime rates are stabilizing or declining. This is by no means to argue that fear of crime is unjustified. Crime has risen enormously in the United States in the last quarter-century, but it is no more serious in 1994 than it was in 1991. The FBI's crime index declined 4 percent from 1991 to 1992.

In California, a legislative report released in January indicates that the overall crime rate per 100,000 people declined slightly from 1991 to 1992, dropping from 3,503.3 to 3,491.5. Violent crimes—homicide, forcible rape, robbery, and aggravated assault—rose slightly, from 1,079.8 to 1,103.9. Early figures for 1993 show a small decline.

On the other coast, New York City reported a slight decline in homicides, 1,960 in 1993, compared with 1,995 in 1992, and they are clustered in 12 of the city's 75 police districts, places like East New York and the South Bronx. "On the east side of Manhattan," writes Matthew Purdy in the *New York Times*, "in the neighborhood of United Nations diplomats and quiet streets of exclusive apartments, the gunfire might as well be in a distant city."

So why, when crime rates are flat, has crime become America's number one problem in the polls? Part of the answer is that fear of crime rises with publicity, especially on television. Polly Klaas's murder, the killing of tourists in Florida, the roadside murder of the father of former basketball star Michael Jordan, and the killing of commuters on a Long Island Railroad train sent a scary message to the majority of Americans who do not reside in the inner cities. The message seemed to be that random violence is everywhere and you are no longer safe—not in your suburban home, commuter train, or automobile—and the police and the courts cannot or will not protect you.

A recent and as yet unpublished study by Zimring and Hawkins argues that America's problem is not crime per se but random violence. They compare Los Angeles and Sydney, Australia. Both cities have a population of 3.6 million, and both are multicultural (although Sydney is less so). Crime in Sydney is a serious annoyance but not a major threat. My wife and I, like other tourists, walked through Sydney at

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night last spring with no fear of being assaulted.

Sydney's crime pattern explains the difference. Its burglary rate is actually 10 percent higher than L.A.'s, and its theft rate is 73 percent of L.A.'s. But its robbery and homicide rates are strikingly lower, with only 12.5 percent of L.A.'s robbery rate and only 7.3 percent of L.A.'s homicide rate.

Americans and Australians don't like any kind of crime, but most auto thefts and many burglaries are annoying rather than terrifying. It is random violent crime, like a shooting in a fast-food restaurant, that is driving fear.

Violent crime, as I suggested earlier, is chiefly the work of young men between the ages of 15 and 24. The magnitude of teenage male involvement in violent crime is frightening. "At the peak age (17)," Delbert Elliott writes, "36 percent of African-American (black) males and 25 percent of non-Hispanic (white) males report one or more serious violent offenses." Nor are young women free of violence. One in five African-American females and one in ten white females report having committed a serious violent offense.

Blacks are more likely than whites to continue their violence into their adult years. Elliott considers this finding to be an important insight into the high arrest and incarceration rates of young adult black males. As teenagers, black and white males are roughly comparable in their disposition to violence. "Yet," Elliott writes, "once involved in a lifestyle that includes serious forms of violence, theft, and substance use, persons from disadvantaged families and neighborhoods find it very difficult to escape. They have fewer opportunities for conventional adult roles, and they are more deeply embedded in and dependent upon the gangs and the illicit economy that flourish in their neighborhoods."

The key to reformation, Elliott argues, is the capacity to make the transition into conventional adult work and family roles. His data show that those who successfully make the change "give up their involvement in violence." Confinement in what will surely be overcrowded prisons can scarcely facilitate that transition, while community-based programs like Delancey Street have proven successful.

Just as violent crime is concentrated among the young, so is drug use. Drug treatment must be a key feature of crime prevention both in prisons and outside. There is some good news here. In early 1994, President Clinton and a half-dozen cabinet members visited a Maryland prison that boasts a model drug-treatment program to announce a national drug strategy that sharply increases spending for drug treatment and rehabilitation. Although the major share of the anti-drug budget, 59 percent, is still allocated to law enforcement, the change is in the right direction. A number of jurisdictions across the country have developed promising court-ordered rehabilitation programs that seem to be succeeding in reducing both drug use and the criminality of drug-using offenders.

Drugs are one area where get-tough policies to disrupt supply have been a signal failure, both internationally and domestically. Interdiction and efforts to suppress drug agriculture and manufacture within such countries as Peru and Columbia have run up against what I have called "the Darwinian Trafficker Dilemma." Such efforts undercut the marginally efficient traffickers, while the fittest—the most efficient, the best organized, the most ruthless, the most corrupting of police and judges—survive. Cocaine prices, the best measure of success or failure, dropped precipitously in the late 1980s. They have recovered somewhat, but likely more from monopolistic pricing than government interference.

Domestically, get-tough intuitions have inspired us to threaten drug kingpins with long prison terms or death. Partly, we wish to punish and incapacitate them, but mostly we wish to deter others from following in their felonious paths. Unfortunately, such policies are undermined by the "Felix

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Mitchell Dilemma," which I named in honor of the West Coast's once notorious kingpin, who received a life sentence in the 1980s, albeit a short one since he was murdered in federal prison. Mitchell's sentence and early demise did not deter drug sellers in the Bay Area. On the contrary, drug sales continued and, with Mitchell's monopolistic pricing eliminated, competition reduced the price of crack. The main effect of Mitchell's imprisonment was to destabilize the market, lower drug prices, and increase violence as rival gang members challenged each other for market share. Drug-related drive-by shootings, street homicides, and felonious assaults increased.

Recently, two of Mitchell's successors, Timothy Bluitt and Marvin Johnson, were arrested and sent to prison. So will peace finally come to the streets? "When a guy like Bluitt goes down, someone takes his place and gets an even bigger slice of the pie," an anonymous federal agent told the *San Francisco Chronicle* this past January. "The whole process is about consolidating turf and power."

Youngsters who sell drugs in Oakland, Denver, Detroit, South Central Los Angeles, Atlanta, and New York are part of generations who have learned to see crime as economic opportunity. This does not excuse their behavior, but it does intensify our need to break the cycle of poverty, abuse, and violence that dominates their lives. Prisons do not deter criminals partly because the Mitchells and Bluitts do not rationally calculate choices with the same points of reference that legislators employ. Drug dealers already face the death penalty on the streets.

History reminds us that gang violence is not novel, but it has not always been so lethal. The benchmark sociological study of the urban gang is Frederick Thrasher's research on 1,313 Chicago gangs published in 1927. The disorder and violence of these gangs appalled Thrasher, who observed that they were beyond the ordinary controls of police and other social agencies. He described gang youth, of which only 7.2 percent were "Negro," as "lawless, godless, wild." Why didn't more of them kill each other? They fought with fists and knives, not assault weapons.

Preventing Violent Crime

If violent crime prevention is our strategic aim, we need to test tactics. We need to go beyond the Brady Bill and introduce a tight regulatory system on weapons and ammunition, and we need more research and analysis to figure out what control system would be most effective. Successful gun and ammunition control would do far more to stem the tide of life-threatening violence than expensive prisons with mandated sentences.

The Senate crime bill, however, promises to increase the nation's rate of imprisonment. Besides its three strikes provisions, the legislation incorporates Senator Robert Byrd's $3 billion regional prison proposal. If enacted, states can apply to house their prisoners in 10 regional prisons, each with a capacity of 2,500 inmates.

To qualify, states must adopt "truth in sentencing" laws mandating that offenders convicted of violent crimes serve "at least 85 percent of the sentence ordered," the current average served by federal offenders. They also must approve pretrial detention laws similar to those in the federal system. And the states must ensure that four categories of crime—murder, firearms offenses resulting in death or serious bodily injury, sex offenses broadly defined, and child abuse—are punished as severely as they are under federal law. In effect, the Senate crime bill federalizes sentencing policy.

According to H. Scott Wallace of the National Legal Aid and Defender's Association, the mandate will add about 12,000 prisoners to the average state's correctional population but will offer only about 3 percent of the space needed to house them.

The most costly provision of the Senate crime bill—$9 billion worth—is its proposal for 100,000 more police, a measure endorsed by the administration. Its potential

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value in reducing crime is unclear. We need more research on constructive policing, including community policing, which can be either an effective approach or merely a fashionable buzzword. We need to address the deficiencies of police culture revealed in the corruption uncovered by New York City's Mollen Commission and the excessive force revealed on the Rodney King beating videotape. More police may help in some places but not much in others. And they are very expensive.

A leading police researcher, David H. Bayley, has explained the ten-for-one rule of police visibility: ten cops must be hired to put one officer on the street. Only about two-thirds of police are uniformed patrol officers. They work three shifts, take vacation and sick leave, and require periodic retraining. Consequently, 100,000 new officers will mean only about 10,000 on the street for any one shift for the entire United States.

Even if we were to have more and better police, there is no guarantee they will deter crime. Criminologists have found no marginal effect on crime rates from putting more cops on the street. Indeed, Congress and the president need look no farther than down their own streets to discover that simply increasing police doesn't necessarily make the streets safe. Washington, D.C., boasts the highest police-per-resident ratio in the nation with one cop for every 150 civilians. It is also America's homicide capital.

We might get more bang for the patrolling buck by investing in para-police, or the police corps, or private police, rather than by paying for more fully sworn and expensive officers. Under the leadership of former Chief Raymond Davis, Santa Ana, California, had the most effective community-oriented policing department in the nation. Davis, who faced a weak police union, could innovate with community- and service-oriented civilians who wore blue uniforms but carried no guns—a new and cost-effective blue line.

The crime bill allocates approximately $3 billion for boot camps, another get-tough favorite. Criminologist Doris MacKenzie has found, contrary to intuition, no significant difference between camp graduates and former prison inmates in the rate at which they return to prison. Similarly, a General Accounting Office report concluded that there is no evidence that boot camps reduce recidivism.

If the public wants boot camps primarily for retribution, it doesn't matter whether they work. Under the Eighth Amendment's bar on cruel and unusual punishment, we're not permitted to impose corporal punishment with whips and clubs. In boot camps, however, we can require painful exercises and hard and demeaning labor to teach these miscreant youth a message of retribution. But if correctional boot camps are intended to resocialize youth and to prepare for them noncriminal civilian life, the camps are inadequate.

We need to experiment with boot camps plus—the "plus" including skills training, education, jobs, community reconstruction. Conservatives who stress moral revitalization and family values as an antidote to youth crime have the right idea. Yet they rarely, if ever, consider how important are the structural underpinnings—education, opportunity, employment, family functioning, community support—for developing such values.

Eventually, we are going to have to choose between our retributive urges and the possibilities of crime prevention. We cannot fool ourselves into thinking they are the same. The punishment meted out by criminal law is a blunt and largely ineffectual instrument of public protection. It deters some, it incapacitates others, and it does send a limited moral message. But if we want primarily to enhance public safety by preventing crime, we need to mistrust our intuitions and adopt strategies and tactics that have been researched, tested, and critically evaluated. In short, we need to embrace the values of the enlightenment over those of the dark ages.◆

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Orphans of Separatism

The Painful Politics Of Transracial Adoption

Randall Kennedy

No issue more highlights feelings of ambivalence over the proper place of racial distinctions in American life than the delicate matter of transracial adoptions. Opponents of such adoptions insist that allowing white adults to raise black children is at worst tantamount to cultural genocide and at best a naive experiment doomed to failure. In most states, custom reflects and reinforces these beliefs; public policy, formally or informally, discourages cross-racial adoptions or foster placements, to the point where thousands of children are denied placement in loving homes.

Now one of the Senate's leading liberals is compounding the damage with a well-intentioned but badly misguided bill titled the Multiethnic Placement Act. Senator Howard Metzenbaum of Ohio sees his bill as a deft compromise. On the one hand, the bill prohibits state agencies or agencies that receive funds from the federal government from completely barring or unduly delaying transracial child placements, either for adoptions or foster care. This aspect of the bill has provoked the opposition of those who strongly favor racial matching, the policy that seeks to place children of a given race with foster parents or adoptive parents of the same race. On the other hand, the bill evinces a preference for racial matching by explicitly stating that race may be taken into account in making child placement determinations and by prohibiting only *undue* delays caused by efforts at racial matching (thereby implicitly authorizing some delay). This preference stems from Metzenbaum's own belief that "every child who is eligible for adoption has the right to be adopted by parents of the same race," and that "teaching a child self love and to embrace their racial and cultural heritage is more easily accomplished when parents and children are of the same race or ethnic group."

Metzenbaum thus embraces *moderate* racial matching. While he does not favor barring transracial child placements altogether, he views such arrangements as distinctly less desirable than racially matched child placements. Many intelligent, caring, thoughtful people of good will agree with Senator Metzenbaum. His legislation is supported by Marian Wright Edelman's Children's Defense Fund and is echoed by an editorial in the *New York Times*, which declared that while total prohibition of transracial adoptions is unwise, "Clearly, matching adoptive parents with children of the same race is a good idea."

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These good people are wrong. To understand why and the stakes involved in their error, one must confront three overlapping social disasters.

The first is the fact that increasingly large numbers of children bereft of functioning parents are flooding social welfare agencies. Agencies are charged with maintaining these young refugees from destroyed families and either placing them in the temporary care of foster parents or the permanent care of adoptive parents. According to Metzenbaum, the number of such children has exploded from 276,000 in 1986 to 450,000 in 1992—a vivid and concrete manifestation of what happens when poverty, crime, and substance abuse tear families apart.

Like most social catastrophes in the United States, this one weighs most heavily upon racial minority communities: the percentage of minority children in need of foster care or adoptive homes is far greater than their percentage of the population. In Massachusetts, approximately 5 percent of the population is black, yet black children constitute nearly half of the children in need of foster care or adoptive homes. In New York City, 75 percent of the nearly 18,000 children awaiting adoption are black. Nationwide, there are about 100,000 children eligible for adoption; 40 percent are black. While two years and eight months is the median length of time that children in general wait to be adopted, the wait for black children is often twice that long.

Conceiving of the deprivations suffered by children without parents is both easy and difficult. It is easy because some of the things that we expect parents to do are so obviously important. We expect parents to protect the interests of their children in a singular fashion, to show a degree of loyalty that cannot be bought, to demonstrate a mysterious allegiance deeper than professional duty. It is difficult because of the enormity of even attempting to calibrate the manifold, subtle, perhaps even unknowable losses borne by parentless children. There is one thing, however, about which we can be sure: it is a tragic condition indeed for a child to be condemned to the limbo of parentlessness, to suffer the loneliness of having no one to call "mother" or "father," to be exposed to the anxiety of having no family that is permanently and intimately one's own.

A second social disaster compounds the first. It is the disaster of racial matching itself. Racial-matching policies can vary in intensity, from absolute prohibitions against transracial child placements to temporary preferences for same-race placements. Examples of the former are state laws in the segregationist Jim Crow South that forbade adoption across the race line and, more recently, the position of the National Association of Black Social Workers, which categorically opposes transracial adoptions involving black children and white parents. Examples of the latter include the customary practices of many social workers around the country and statutes like the ones in California, Minnesota, and Arkansas which require that social workers spend a given amount of time—90 days in California—seeking a same-race adoption for children before they are made available to prospective adoptive parents of a different race.

Racial matching is a disastrous social policy both in how it affects children and in what it signals about our current attitudes regarding racial distinctions. In terms of immediate consequences, strong forms of racial matching block some parentless children from access to adults who would otherwise be deemed suitable as parents except that they are disqualified on the grounds that they are of the "wrong" race. In some jurisdictions, the relevant decision-makers simply refuse to permit child placements across the color line. In others, authorities will permit foster care across racial lines but then remove the child if they move to deepen the relationship from mere temporary foster care to permanent adop-

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tion. In still other jurisdictions, social welfare agencies delay placing children with adoptive parents of the "wrong" race until efforts are undertaken to place the child with adoptive parents of the "right" race. Delay of any length is, of course, a cost in and of itself. While three months might seem like a negligible delay from the perspective of adults, such delays are lengthy indeed from the perspective of infants. Moreover, for many adults, children become less attractive as adoptees as they age. What seems at first like mere delay may obliterate the chance of some youngsters for adoption at all; prospective adoptive parents willing to adopt a child of six months may not be willing to adopt the same child at one year.

Furthermore, given that racial matching mirrors and reinforces the belief that same-race child placements are better and therefore preferable to transracial arrangements, some adults seeking to become foster or adoptive parents are likely to steer clear of transracial parenting. Some adults who would be willing to raise a child regardless of racial differences find themselves unwilling to do so in the face of social pressures that stigmatize transracial adoption as anything from second-best to cultural genocide. What this means in practice is that racial matching narrows the pool of prospective parents, which in turn either delays or prevents the transmission of children in need of parents to adults able and willing to serve as parents. How much misery this adds to our pained country is difficult to calibrate. That racial matching adds a substantial amount of misery, however, is inescapable.

The other level on which racial matching is disastrous has to do with its diffuse, long-term moral and political consequences. Racial matching reinforces racialism. It strengthens the baleful notion that race is destiny. It buttresses the notion that people of different racial backgrounds really are different in some moral, unbridgeable, permanent sense. It affirms the notion that race should be a cage to which people are assigned at birth and from which people should not be allowed to wander. It belies the belief that love and understanding are boundless and instead instructs us that our affections are and should be bounded by the color line regardless of our efforts.

When he introduced the Multiethnic Placement Act, Senator Metzenbaum railed against the strongest versions of racial matching. "Some agencies," he noted disapprovingly, "prevent the adoption of children by prospective parents of a different race, even after the child and parents have bonded after years of living together in a loving foster care home." He stated that his bill would "make it clear that race, national origin or color cannot be the only consideration in making foster care and adoptive placements." Note, however, that he attacks only the most extreme version of racial matching, that which wholly prevents transracial child placements. He leaves alone and indeed authorizes less extreme or obvious versions of racial matching.

There is no evidence that black adoptive parents do better than white adoptive parents in raising black children.

This suggests a third social disaster: the mixture of confusion and weakness that disables many people of good will from combating as fully as they might deeply ingrained racialist impulses. Metzenbaum's position not only reflects this failing but compounds it. True, he is a *moderate* racial matcher. There are, as noted above, more fervent and rigid supporters of racial matching who oppose Metzenbaum's proposed legislation because, in their view, it fails to go far enough in the defense of racial matching. But he apparently does accept the premises of racial matching, preferring

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same-race child placements so long as they can be accomplished without too high a cost.

What the senator and those who support his legislation have failed to appreciate sufficiently is that, under our law, the drawing of racial distinctions, particularly by government officials, is and should be presumptively illegitimate. Federal constitutional law, for instance, establishes that when government officials use racial criteria in their decision-making, they bear a heavy burden of justification. This aversion to racial criteria stems from our long and bitter history with them, an experience that includes slavery, open, invidious racial distinctions, and *de jure* segregation. This history suggests that far more often than not, there exists no good reason to draw racial distinctions.

This does not mean that all racial criteria are illegitimate, only that all are presumptively illegitimate. Therefore, if racial criteria are to be used, the burden of persuasion rests on those in favor of using such criteria. Thus, in this context, the burden of persuasion rests not upon those who object to the use of racial criteria in making child placement decisions but rather upon those who wish to use such criteria. The burden of persuasion properly rests upon the proponents of racial matching, not those who contend, as I do, that race ought to play no part in child placement decisions.

There is no rationale sufficiently compelling to justify preferring same-race child placements over transracial placements. One asserted reason for favoring same-race placements (at least in terms of black children) is that African-American parents can, on average, better equip African-American children with what they will need to know in order to survive and prosper in a society that remains, in significant degree, a pigmentocracy. This rationale is doubly faulty.

First, it rests upon a racial generalization, a racial stereotype, regarding the relative abilities of white and black adults in terms of raising African-American children. Typically (and the exception does not apply here), our legal system rightly prohibits authorities from making decisions on the basis of racial generalizations, even if the generalizations are accurate. Our legal system demands that people be given individualized consideration to reflect and effectuate our desire to accord to each person respect as a unique and special individual. Thus, if an employer used whiteness as a criteria to prefer white candidates for a job on the grounds that, on average, white people have more access to education than black people, the employer would be in violation of an array of state and federal laws—even if the generalization used by the employer is accurate. We demand as a society a more exacting process, one more attentive to the surprising possibilities of individuals than the settled patterns of racial groups. Thus, even if one believes that, on average, black adults are better able than white adults to raise black children effectively, it would still be problematic to disadvantage white adults, on the basis of their race, in the selection process.

Second, there is no evidence that black foster or adoptive parents, on average, do better than white foster or adoptive parents in raising black children. The empirical basis for this claim is suspect; there are no serious, controlled, systematic studies that support it. Nor is this claim self-evidently persuasive. Those who confidently assert this claim rely on the hunch, accepted by many, that black adults, as victims of racial oppression, will generally know more than others about how best to instruct black youngsters on overcoming racial bias. A counter-hunch, however, with just as much plausibility, is that white adults, as insiders to the dominant racial group in America, will know more than racial minorities about the inner world of whites and how best to maneuver with and around them in order to advance one's interests in a white-dominated society.

To substantiate the claim that black adults will on average be better than white

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adults in terms of raising black children, one must stipulate a baseline conception of what constitutes correct parenting for a black child—otherwise, one will have no basis for judging who is doing better than whom. Metzenbaum and other moderate proponents of racial matching imply that white foster or adoptive parents will be, on average, less capable of instilling within a black child an appropriate sense of self-worth and an appropriate racial identity. There exists, however, no consensus on how best to raise a black child (or, for that matter, any other sort of child) or on what constitutes a proper sense of self worth or on what constitutes an appropriate racial identity or on how one would go about measuring any of these things. Is an appropriate sense of blackness evidenced by celebrating Kwanza, listening to rap, and seeking admission to Morehouse College? What about celebrating Christmas, listening to Mahalia Jackson, and seeking admission to Harvard? And what about believing in atheism, listening to Mozart, and seeking admission to Bard? Are any of these traits more or less appropriately black? And who should do the grading on what constitutes racial appropriateness? Louis Farrakhan? Jesse Jackson? Clarence Thomas?

Some moderate proponents of racial matching contend that, on average, white adults seeking foster or adoptive children will be less able than similarly situated black adults to tell these children how best to meet the racial impediments they will surely face. But what is the best advice to give? Blacks do not agree. Nor do whites. Again the key point is that there exists no consensus on how best to raise a black child or any other child.

In light of this lack of consensus, the tenuousness of our information regarding the relationship of racial status to social knowledge, the ever-growing complexity of our multicultural society, and our well-taken aversion to official racial distinctions in the absence of clear, strong justifications for them, our government should reject any scheme that engages expressly in racial steering on the basis of a hunch that certain people—because of their race, color or national origin—will know better how to raise a child than other people of a different race, color, or national origin. If officials are satisfied that adults seeking foster or adoptive children are safe, sober folk, they should have to pass no racial screening. What parentless children need are not "white," "black," "yellow," "brown," or "red" parents but *loving* parents.

Yet another reason advanced in favor of moderate racial matching is that it may serve to save a child from placement in a transracial family setting in which the child will be made to feel uncomfortable by a disapproving surrounding community. It would be a regrettable concession, however, to allow bigotry to shape our law. One of the asserted justifications of segregation was that it protected blacks from the wrath of those whites who would strongly object to transracial public schooling and transracial accommodations in hotels and restaurants. When the *New York Times* editorializes today that "clearly, matching adoptive parents with children of the same race is a good idea," we should recall that not very long ago it was believed in some parts of this nation that "clearly" it was a good idea to match people of the same race in separate but equal parks, hospitals, prisons, cemeteries, telephone booths, train cars, and practically every other place one can imagine—all for the asserted purpose of accommodating the underlying racial sentiments of those who opposed "racial mixing."

Some of the most admirable rulings in the history of the Supreme Court have involved rejections of just this sort of accommodation—first, in striking down *de jure* segregation in *Brown v. Board of Education* and, second, in refusing to allow racialist opposition to nullify its ruling. In 1958 some of the white people of Little Rock vociferously, and even violently, protested the admission of black children into a formerly all-white public high school.

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In response, the local school board decided to suspend its efforts to desegregate the school. But in the same year, in *Cooper v. Aaron*, the Supreme Court ruled against the school board and ordered that the desegregation plan be reinstated. "The constitutional rights of [the black school children] are not to be sacrificed or yielded," the court declared, "to violence and disorder." More recently, in 1984 in *Palmore v. Sidoti*, the Supreme Court faced a

Liberals are abandoning their commitment to creating a society in which racial difference withers away into moral insignificance.

situation in which a Florida state court judge awarded custody of a child to her white natural father when the child's white natural mother married a black man. The Florida judge stated that it would be in the best interest of the child to be raised in a racially homogeneous household given the ostracism she was likely to face if she continued to live with her mother in a transracial household. Again the Supreme Court reversed the judgment of the local authorities. Echoing *Cooper*, the Court maintained in *Palmore* that racialist opposition to transracial living arrangements should not be used as a basis for using racial criteria in making child placement decisions.

There are a growing number of cases in which courts have given relief to children and adults who have been kept apart by officials who, on racial grounds, have clearly prevented transracial foster care or adoption. But significant obstacles impede bringing unlawful conduct to the attention of judges. The government agencies that are supposed to advance the best interests of the children under their care are all too often directed by people who either favor racial matching (particularly its moderate version) or fear confronting those who do. Furthermore, adults who are separated by racial matching from children they might otherwise parent face the bitter reality that, even when the law is on your side, litigation is expensive, time-consuming, nerve-wrenching, and uncertain. If a social welfare official offers a non-racial, pretextual reason for making a child placement decision, it will often be difficult to prove that an illicit racial reason animated the decision. This is especially so in the area of child welfare, where courts typically defer even more than they normally do to the presumed expertise of social welfare professionals.

The Multiethnic Placement Act raises a somewhat different legal issue: the status of a legislative directive that openly instructs officials that they may take race into account in making child placement decisions so long as race is not the only factor considered in determining what placement to make in the best interest of a child. There are, as noted above, strong reasons to believe that the Multiethnic Placement Act should be found to be in violation of the Equal Protection Clause of the Constitution. On the other hand, it is at least thinkable that the Supreme Court would reject a challenge to the act. First, the court typically grants more deference to racial distinctions made by Congress than to racial distinctions made by the states. Second, by authorizing the use of a racial criterion only in conjunction with other factors, the sponsors of the Multiethnic Placement Act resort to a formula that the Supreme Court has used to justify racial criteria in the affirmative action context. In his decisive 1976 opinion in *University of California at Davis v. Bakke*, Justice Lewis Powell gave his blessing to affirmative action programs in which race is used along with other considerations in selecting candidates for admission to institutions of higher education. Last year, in *Shaw v. Reno*, which involved the constitutionality of using racial criteria to design congressional districts, Justice Sandra Day O'Connor, writing for the

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court, seemed to suggest that what bothered her most about the case was that racial characteristics seemed to have been virtually the only thing that mattered to those doing the districting. Given that the Multiethnic Placement Act explicitly states that race may be used only in concert with other considerations, the court might uphold it.

The court, however, would be wrong in doing so. First, a compelling justification should be demanded whenever a racial distinction is drawn, which means that there should be no diminution of scrutiny simply because the Congress purports to authorize the use of a racial distinction along with other factors. Second, as everyone knows or should know, authorizing the use of racial criteria at all will mean in practice the authorization of racial matching—so long as social welfare bureaucrats who favor the practice take minimal steps to obscure the real basis of their decisions.

Some influential sectors of the civil rights community steer far clear of this controversy, particularly the argument advanced here, because they fear implications that might cast a shadow over affirmative action plans. Their fears are understandable; legitimating racial distinctions for purposes of affirmative action in higher education and employment do put a strain on the Equal Protection Clause and antidiscrimination statutes. But with respect to racial preferences in those contexts, it can at least be said that the aim is integrative: the purpose of preferring racial minority candidates is to speed the process of racially integrating sectors of American life from which racial minorities have long been wrongly excluded. By contrast, there is no integrative purpose or effect to racial matching, even in the moderate form authorized by the Metzenbaum bill. To the contrary, its expressed purpose and obvious consequence is to maintain the racial status quo, at least in terms of constituting families.

Supporters of the Multiethnic Placement Act contend that opponents of racial matching should nonetheless support this bill because it at least attacks the worst excesses of racial matching. Sometimes, however, half-steps in addressing a problem are more dangerous than inaction. The Multiethnic Placement Act will fail in its effort to prevent those lengthy delays which even proponents of racial matching recognize as hurtful. It will fail because, as the sponsors of the bill themselves recognize, there exists already a widespread and deeply-ingrained practice of discouraging transracial placements even when the cost of doing so is consigning children to lengthy or indefinite stays in institutional limbo. Attempting to make fine distinctions between acceptable and unacceptable delay will fail to uproot this pernicious practice. Indeed, the Multiethnic Placement Act will likely worsen the situation. At present, there exists no congressional authority for racial matching; if this bill is enacted, such authority will exist.

There is more at stake in the struggle over the Multiethnic Placement Act than has been at stake in any bill involving race relations that the Congress has faced since the passage of the Civil Rights Act of 1964. That this year marks the 30th anniversary of the Civil Rights Act puts into sharp relief the significance of the pending legislation. That act constituted an effort to remove the color line from large areas of American life. It forbade discrimination on the basis of race in public accommodations and in much of the private employment market. It also authorized the cutting off of federal funds from any agency which discriminated on the basis of race. Yet, here we are, 30 years later, with racialist legislation proposed and sponsored by some of Congress's most distinguished liberal senators: Howard Metzenbaum of Ohio, Edward Kennedy of Massachusetts, Christopher Dodd of Connecticut.

The Multiethnic Placement Act looks down upon transracial placements, making them second-class arrangements to be resorted to when all else fails. There was a

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time when forward-looking people would have thought it praiseworthy for prospective adoptive parents to have said to a state social welfare agency, "We are willing to raise a parentless child regardless of the child's race." Now we confront legislation that openly denigrates such people, portraying them as a mere fallback for parentless children of a different race than they.

When Senator Metzenbaum introduced the Multiethnic Placement Act, he ended his announcement by stating solemnly that his legislation "reaffirms the fundamental principle that our child welfare system should judge people by the content of their character and not by the color their skin." But this is Orwellian double-speak. The stated aim of the bill is to decrease the length of time that children wait to be adopted. Yet it expressly permits delay for the purpose of racial matching, prohibiting only "undue" delay. The bill's stated aim is to prevent discrimination in the placement of children on the basis of race, color, or national origin. Yet the bill expressly permits an agency to "consider the race, color, or national origin of a child as a factor in making a placement decision." Metzenbaum states that the bill "reaffirms the fundamental principle that our child welfare system should judge people by the content of their character and not by the color of their skin." Yet the bill's language does just the opposite.

This state of affairs is, quite simply, a political disaster—at least for integrationists like me who view the anti-racialist impulse of the civil rights movement circa 1963 as the great guiding sentiment around which struggles for racial justice should continue to cohere. Whether or not they recognize it, many liberals have abandoned their commitment to creating a society in which racial difference withers away into moral insignificance. Instead, often marching under the banner of "diversity," they have acquiesced to measures that are moving us toward a society in which one's racial background is deemed to have a definite, positive, moral meaning that the government officially recognizes, reinforces, and celebrates.

Many conservatives are also blameworthy. Some who merely tolerate the changes wrought by the civil rights revolution, because they can effectively do nothing about them, probably like the fact that racial matching is prevalent and may soon receive congressional approval; after all, racial matching validates to some degree the separatist intuitions that animated *de jure* segregation. Others are simply indifferent to this issue. Not all are; Professor Charles Fried of Harvard Law School, Ronald Reagan's solicitor general, has been actively, eloquently, and rightly engaged in opposing the Multiethnic Placement Act. But he is unusual among conservatives, and the indifference shown by his ideological kin is itself noteworthy. Conservatives of various sorts unite in their attacks against racial preferences in educational and employment settings. But for the most part conservatives who loudly decry liberals' use of racial criteria in other settings have been noticeably quiet about the Multiethnic Placement Act.

Unfortunately, one plausible explanation for this is that while they care intensely about the disadvantage imposed upon whites by preferential treatment in education and employment, they care little about the burdens imposed by racial matching, burdens that hurt everyone but that hurt racial minority children in particular.

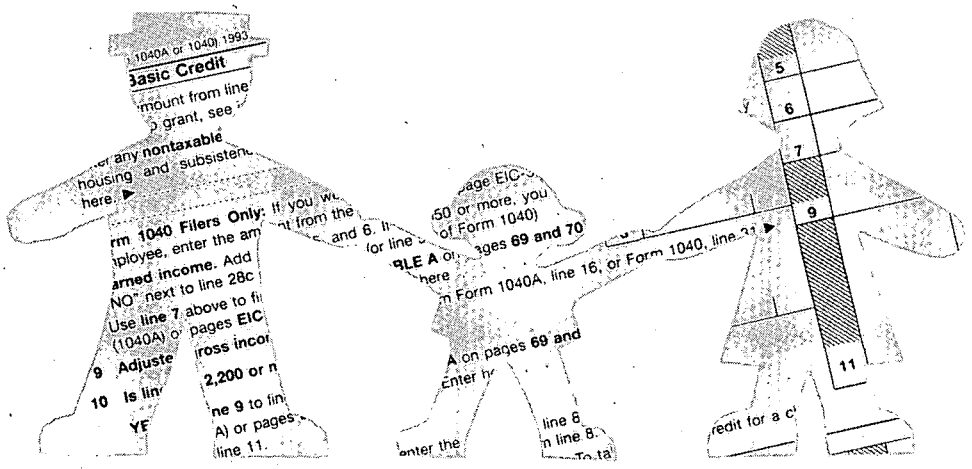
The only happy thing about this story is that an end to it has not yet been written. The Multiethnic Placement Act has not yet been enacted. Perhaps its objectionable aspects will be satisfactorily modified. Perhaps alternative legislation barring all race matching will supersede Metzenbaum's bill. Perhaps the president will veto the bill or the courts will invalidate it. But whatever happens, the fact that such a bill even exists in 1994—40 years after *Brown*, 30 years after the Civil Rights Act of 1964—is evidence that there is much to be done in order to create a more just, decent, and attractive society.♣

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Happy Returns

How the Working Poor Got Tax Relief

Christopher Howard



Once an obscure tax loophole, the Earned Income Tax Credit has achieved policy stardom in recent years. While many programs for the poor have been ravaged over the last decade in the name of political and fiscal temperance, the EITC has prospered. Its annual cost rose from $2 billion to $12 billion between 1980 and 1992. And the 1993 budget agreement expands the program by some $20 billion over five years—even as it cuts billions of dollars from middle-class programs like Medicare and federal employee pensions. The EITC has ardent supporters across the political spectrum, and both Democrats and Republicans have claimed it as their own.

The most obvious reason for the EITC's bipartisan popularity is its consistency with basic American values. Because benefits go only to people who work for wages, the EITC reinforces the work ethic. Moreover, it appears consistent with the ideal of limited government; there is no need for social service bureaucracies since individuals determine their eligibility and benefits themselves when they fill out their yearly tax form. A refundable tax credit, the EITC will for most recipients not only offset the income taxes they would otherwise owe but also entitle them to a rebate check. In 1994, the combined value of the tax offset and rebate check will average about $860 per family.

The EITC has received an additional boost in recent years from two

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directions. Politicians from both parties "discovered" the working poor in the early 1980s and began to compete for their votes. Diverse politicians have also learned to capitalize on the program's inherent ambiguity. Because the EITC is an open-ended cash transfer, proponents have been able to portray it as a solution to any number of problems affecting the working poor, ranging from high payroll taxes to low wages to inadequate child care.

Whenever left and right are this enthusiastic about the same program, it invites close scrutiny. How did the EITC become so popular? Is it really a boon to the working poor?

Humble Origins

What started out in 1975 as a footnote to an unremarkable tax bill has become the federal government's largest income transfer to the poor, larger even than its share of Aid to Families with Dependent Children (AFDC). The EITC was born out of the welfare debates in the late 1960s and early 1970s. The program's creator, Democratic Senator Russell Long of Louisiana, had throughout his career used the tax code to make social and economic policy, a natural inclination for someone with jurisdiction over taxing and not spending. In the early 1970s, as the powerful chairman of the Senate Finance Committee, Long led a group of congressional conservatives and moderates who felt the Nixon administration's proposed Family Assistance Plan (FAP) was too generous. In particular, they opposed its guarantee of an annual income to all families with children, regardless of whether the parents worked, on the grounds that it would discourage recipients from working.

But FAP also contained a wage supplement for the working poor, and in his alternative proposal Long emphasized the theme of the government's responsibility to help the working poor. In 1972, his workfare bill included a "work bonus," a tax rebate equal to 10 percent of wages, available to heads of households with children and a family income under $4,000 (roughly the poverty line for a family of four). Incorporated in the Senate's version of welfare reform, the proposal died in Congress that year, as did FAP.

After 1974, Long changed his strategy. Instead of pitching his initiative as welfare

The Escalating EITC

The value of the EITC varies by income and, since 1991, slightly by family size. In 1993, for families with two or more children and adjusted gross income between $7,760 and $12,210, the maximum credit was $1,511; for families with one child, the credit was $1,434. (Most recipients receive their credit as an annual lump-sum benefit, but a few use the advance payment option, which provides a small but steady stream of cash benefits.) A family of four gained almost 20 cents in EITC benefit for every dollar it earned up to $7,760; it enjoyed the same credit for earnings up to $12,210; and it lost 14 cents in EITC benefit for every dollar earned above $12,210. The benefit phased out completely at $23,020 in earnings.

The 1993 budget agreement will substantially increase the maximum value of the credit (to $3,370) and extend the phase-out range to around $27,000 for families with two or more children. Families with only one child will receive a much smaller increase. The budget will also create for the first time a small (up to $300) tax credit for workers who have no children and earn less than $9,000 per year.

In 1993, about 14 million families received the EITC. With the budget changes, by 1998 a couple million more recipients will be added, and the cost of the program will rise by nearly 50 percent, to roughly $20 billion per year.

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reform, he emphasized tax relief. His work bonus would reduce the tax burdens of low-income workers, which had risen in recent years with increases in regressive payroll taxes for Social Security and Medicare.

After a dispute with Oregon Democrat Al Ullman, the new chairman of the House Ways and Means Committee, over whether to cover all low-income workers or only parents of dependent children, Long's narrower version prevailed in conference. Long dominated the House-Senate conference committee primarily because of the institutional disarray in the House. The winds of reform that shook Congress in the late 1960s and early 1970s hit Ways and Means particularly hard, peaking in 1974-75. Further, the ouster of Wilbur Mills as Ways and Means chairman in a sex scandal a year earlier had eroded the committee's expertise in tax matters and its bargaining clout with the Senate Finance Committee. Long's version of the EITC passed easily and quietly into law as a small part of the Tax Reduction Act of 1975.

EITC as Tax Reform

The EITC program remained relatively obscure for almost a decade and actually declined in value. The election of Ronald Reagan in 1980, however, set in motion a series of events that changed the EITC's trajectory dramatically.

One immediate consequence of Reagan's victory was that Democrats and Republicans began competing in earnest for the votes of the working poor, who overlapped with the much publicized Reagan Democrats. Voters earning between $12,000 and $25,000 (a fair approximation of the working poor) comprised about one-fifth of the electorate, and their party affiliation shifted back and forth during the 1980s. Cementing their support could mean the difference between a successful or failed Republican realignment. The defection of Reagan Democrats also provoked considerable soul-searching within the Democratic Party. After doing their best to imitate Republicans in 1981, Democrats began to stress "fairness" in the early 1980s, highlighting the inequities of Reagan's spending and tax cuts.

Buoyed by victories in the 1982 congressional elections, Democrats continued to stress fairness in the mid-1980s. Increasingly they emphasized inequities in the tax code, since spending increases were blocked politically. Led by Representative Charles Rangel of New York, several Democratic members of the House Ways and Means Committee and committee staff encouraged interest groups to shift their lobbying efforts from spending to taxation, and in particular praised the Earned Income Tax Credit. Given the difficulty of increasing direct spending, advocacy groups for the poor, led by the Center on Budget and Policy Priorities, began to push for expansion of the EITC.

Party competition over the working poor, the fairness issue, and the EITC converged during debates over tax reform between 1984 and 1986. Republican strategists, fearing that Mondale and the Democrats would make tax fairness a main theme of the 1984 elections, launched a preemptive strike in January that year. President Reagan announced in his State of the Union address that the Treasury would conduct a major study of tax reform. That move, coupled with economic recovery and Democratic blunders, helped minimize tax reform and fairness as campaign issues.

Although Reagan won in a landslide, his earlier directive to the Treasury unleashed an unexpected torrent of tax reform activity. Its study, known as Treasury I, proposed a dramatic overhaul of the tax code. The centerpiece was a call for dramatically lower tax rates offset by sizable reductions in tax loopholes.

Two years later, Treasury I became the Tax Reform Act of 1986. (For full accounts of its evolution, see Jeffrey Birnbaum and Alan Murray's *Showdown at Gucci Gulch*; and Timothy Conlan, Margaret Wrightson, and David Beam's *Taxing Choices*.) Democrats and Republicans vied for credit for the legislation, which reduced tax rates

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on working and middle-class voters, indexed future benefits to inflation, and substantially expanded the EITC. Indeed, interviews with key participants suggest that the EITC was part of the glue that held the entire tax reform package together. Expanding the EITC enabled legislators to preserve or expand tax benefits for the affluent and still produce an overall package that was distributionally neutral. Policymakers learned that you could be a staunch friend of the rich and still love the EITC.

Everybody's Favorite Program

The EITC continued to grow throughout the 1980s as politicians discovered its broad appeal. Indeed, one measure of EITC's popularity is the disparate policy objectives politicians have enlisted it to serve.

Several congressional Democrats, for instance, proposed expanding the EITC as part of comprehensive welfare reform, in what eventually became the Family Security Act of 1988. Their idea was less to keep working poor families out of poverty than to make work pay for families on AFDC. They dropped their plans when substantially similar changes were included in the Tax Reform Act.

The EITC next surfaced in debates over the minimum wage. After Democrats retook the Senate in 1986, several liberals proposed a substantial increase in the minimum wage, which had declined in value by 25 percent since 1981. Thomas Petri of Minnesota, the ranking minority member of the House subcommittee on labor standards, countered with a smaller increase in the minimum wage and a fairly large increase in the EITC. Petri and other moderate Republicans managed to insert a plank to that effect in the 1988 party platform.

Things got interesting when the Democratic Leadership Council jumped on the EITC bandwagon. The DLC, formed in 1985 in the wake of Mondale's defeat, sought to wrest the party from traditionally liberal policies and constituencies. In the view of DLC members, increasing the minimum wage sent the wrong message to "mainstream" voters. Such a move tied the party to organized labor, antagonized business, was economically inefficient, and left many of the working poor in poverty. DLC members joined congressional Republicans in advocating a smaller increase in the minimum wage and a large increase in the EITC.

Divisions between the parties, among Democrats, and between Congress and the Bush White House ultimately forced policymakers to drop the EITC from the minimum wage bill. In the process, however, it became the favorite alternative to a higher minimum wage: it counted among its supporters congressional Republicans, moderate and conservative Democrats, high-ranking administration officials, and the U.S. Chamber of Commerce. Given such broad support, the question became not whether the EITC would be expanded again but when and by how much.

Much as Democrats and Republicans competed earlier over fairness and tax reform, both fought to be viewed as the pro-family party. Though Reagan invoked "family values" during his 1980 campaign and subsequent presidency, the administration's emphasis on abortion and school prayer enabled Democrats to redefine the issue. They stressed the economic plight of working families.

One battleground of family policy was child care. A 1988 Gallup poll revealed that 39 percent of respondents wanted child care to be a top priority of the next administration. The trick for policymakers—faced with divided government and widening cleavages within the Democratic Party—was to devise a solution that would respond to these concerns and generate bipartisan support.

The central legislative debate was over the Act for Better Child Care, introduced in 1988. The debate involved three highly contentious issues: the propriety of government subsidies to church-run or church-affiliated day care centers; quality standards for day care centers; and the right mix of

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spending and tax expenditures for child care. Democratic members of the Education and Labor committee, backed by liberal groups like the Children's Defense Fund, insisted that tax breaks would make child care more affordable for the middle class but not the poor. The government, they argued, should spend money directly on poor families with children (principally via expansion of the Title XX day care program) and impose regulations to ensure that those children received quality care.

DLC Democrats, on the other hand, wanted the party to stop throwing money at old programs and regulating business so heavily, a view echoed by Republicans. They proposed fewer regulations and argued for spending $9 through the tax code for every $1 spent on Title XX. Most of these tax benefits would come in the form of an expanded EITC. Working-poor parents would then have the freedom to choose between staying at home to care for their children or paying someone else to do it; they would not be forced into government-run day care.

Key liberal Democrats—particularly Tom Downey of New York and George Miller of California—broke the logjam by endorsing greater reliance on tax credits over direct spending. (Not surprisingly, Downey was chairman of the House Ways and Means Human Resources subcommittee; like Russell Long years before, Downey was better able to influence social policy through the tax code than through traditional appropriations.)

Legislators finally agreed on a package that included about $15 billion in tax credits and $4 billion in additional direct spending, spread over several years. Although most of the increase went to the EITC, policymakers also created two related tax expenditures: a tax credit for health insurance for the children of working poor parents and a tax credit for families with children under one year of age. Eligibility requirements for these two new credits and the EITC were linked so that receipt of one would reduce benefits from the others. These changes were incorporated not in a child care bill but as part of the 1990 budget accord. As in 1986, policymakers used increases in the EITC to improve the progressivity of a larger tax bill.

The EITC was again an effective tool for compromise during the 1993 budget agreement. Candidate Clinton had promised health reform, deficit reduction, and investment in human and physical infrastructure. But President Clinton quickly discovered that congressional Democrats were wary of the "tax and spend" label. The solution: an increased EITC. Even though it was a sizable tax expenditure, it was not perceived as "spending." Clinton still had to compromise, principally by changing the goal from lifting every family with one wage earner out of poverty to lifting every family of four. But few in Congress could argue with the idea of making work pay for a large number of families.

The beauty of including the EITC in the deficit reduction package was that it simultaneously offered the working poor some tangible financial help and made the tax side of the package more progressive. The larger EITC more than compensated for increased gasoline taxes among individuals in the lowest tax brackets. It also benefited more households than were affected by increased income taxes, a key consideration for any legislator. Tax relief, tax fairness—the ambiguity of the program once again served it well.

What's Not to Like?

By 1993 the Earned Income Tax Credit had achieved broad bipartisan support in Washington, a precious commodity in an era of weak parties and often polarized rhetoric surrounding social policy. The program has friends in high places, particularly Bill Clinton; David Ellwood, an assistant secretary of Health and Human Services; key members of the Senate Finance and House Ways and Means committees; and Robert Greenstein, director of the Center on Budget and Policy Priorities and a widely respected expert on social policy. Over the

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last decade, this support has translated into continual expansion in the face of persistent budget deficits, cuts in traditional forms of public assistance, and demands for cuts in middle-class entitlements.

The question remains, however, whether the EITC is good policy. The most common criticism of the program is that it has been deceptively hard to administer. Like many tax expenditures, the EITC isn't literally self-executing. Rather, it shifts the burden of administration from government to individuals. The working poor must somehow find out about the program, determine whether they are eligible, and calculate their benefit. None of these steps is easy for people who often lack the formal education and access to professional tax help that is often needed to make sense of the U.S. tax code.

Fortunately, these administrative hurdles have been lowered in recent years. Since 1986, many of the working poor no longer must submit annual tax returns. That is the good news. The bad news is that these changes complicated efforts to make the working poor aware of the program and the possibility of a tax refund. The Treasury and IRS are not really in the business of publicizing tax loopholes or administering social programs; their main mission is to collect revenue.

While government officials have made an effort to heighten public awareness, a more complete campaign was initiated by the Center on Budget and Policy Priorities in the late 1980s. The center has developed a standard information kit, in English and in Spanish, which it distributes to local welfare agencies, churches, unions, businesses, and community groups. (The Center also has EITC fliers in Vietnamese, Chinese, Creole, Russian, and several other languages.) The kit provides technical information about the EITC and suggestions for community-based outreach strategies. It also tells people how to contact the nearest Volunteer Income Tax Assistance office for free help in preparing tax returns.

Other organizations like the National Women's Law Center and the National Law Center on Homelessness and Poverty have targeted child care centers and homeless shelters in order to increase awareness of the program. At the local level, numerous public, nonprofit, and for-profit organizations have sponsored often creative promotional drives and free tax clinics.

Nevertheless, public awareness is not enough. For a number of years, those people who knew about the EITC found it difficult to apply for benefits. Part of the problem was repeated changes to the definitions of eligible families and income thresholds. These rules were simplified in 1990, and IRS officials report that error rates for the EITC have dropped substantially. But the chief culprit was linking eligibility and benefit levels to the child health insurance and young child tax credits, initiated in 1990. The idea behind linkage was to prevent the working poor from "double dipping," from getting too many tax benefits for the same needs. In the process, policymakers made the calculations so complicated that the IRS had to create a separate tax form, Schedule EIC.

Advocates realized almost immediately that a separate tax schedule might discourage people from applying and create errors in the returns of those who did apply. The *New York Times*, an ardent supporter of the program, called these new rules "numbingly complex." Potential recipients had to determine if they had a qualifying child, if that child met age and residency tests, if their family income fell below the adjusted gross income threshold, if they had certain forms of nontaxable earned income (for example, military housing), how much they paid for child care, and how much they paid for child health insurance. The one group who seems to have benefited from this complexity was unscrupulous insurance sales people, who deceived a number of people into buying health insurance under the false pretext that the EITC and related tax credits would cover the cost of their premiums.

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One important but little noted provision of the 1993 budget accord was elimination of the two supplemental tax credits linked to the EITC. This change should make claiming the credit much easier, and perhaps even allow the IRS to eliminate Schedule EIC and reincorporate the EITC as a single line on the 1040 and 1040A forms. It should also help to boost the EITC participation rate, currently estimated at a respectable 80 to 90 percent.

A more vexing problem of administration is how few recipients (less than 1 percent) take advantage of the advance payment option. To use this option, workers must fill out a W-5 form with their employers, comparable in length and complexity to the W-4 form. Considering how routinely strapped for cash the working poor are, policymakers have wondered why more people don't receive the credit as part of their regular paycheck. Furthermore, economists believe that advance payment creates better work incentives than a lump-sum benefit several months later.

In 1991 the General Accounting Office conducted a study of low-wage workers and employers to determine why advance payment was so unpopular. The GAO discovered that many employers were simply unaware of the option; the IRS had alerted them to the EITC but not to advance payment. Consequently, they hadn't encouraged their employees to apply for advance payment. Other employers with a large number of part-time workers found it burdensome to recalculate the EITC advance payment every time their employees' hours fluctuated. They felt they were spending too much time and energy administering a public program.

More surprising were the reasons cited by low-wage workers. Many of them also claimed to be unaware of the advance payment option. A subsequent Gallup poll has found that fewer than one in ten EITC applicants know about the option. But others surveyed by the GAO expressed a clear preference for the lump-sum benefit at the end of the tax year. One reason cited was that workers feared receiving too large a credit during the year, owing money on the annual return, and not having enough money to pay the IRS. Their view was better safe than sorry.

This problem was also addressed in the 1993 budget accord. Beginning in 1994, eligible workers can receive no more than 60 percent of their EITC benefits via advance payment, and the rest when they file their tax return at the end of the year. This way, the working poor won't have to worry about owing Uncle Sam.

A more recent line of criticism concerns basic issues of program design and policy objectives. Some conservatives have become troubled of late by how many millions of people who are not technically "poor" have been added to the program. For example, a family of four earning 150 percent of the poverty line could claim the EITC in 1993, and that figure will increase by 1998. The country cannot afford, detractors argue, another broad-based entitlement.

There is talk of lowering the income threshold and targeting more of the funds exclusively to families below or very close to the poverty line. Such a change should be resisted on several grounds. First, the poverty line is too low a target; people who work hard ought to live better than that line allows. (See John E. Schwarz and Thomas J. Volgy's "Social Support for Self-Reliance," *TAP* Spring 1992.) Second, shortening the phase-out range could create work disincentives unless the maximum benefit were reduced as well (which would limit its ability to move people out of poverty). Otherwise, EITC recipients would be penalized more than the current 14 cents for every additional dollar they earned in 1993. While we know little about the precise effects this current penalty has on work effort, it stands to reason that the effect would be greater the faster the credit is phased out.

Finally, shrinking the client base would compromise one of the program's chief political assets—the fact that it benefits

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large numbers of working poor, whites as well as blacks. The EITC lacks an organized lobby of beneficiaries and third-party providers. The last thing the program needs politically is for its clientele to resemble that of AFDC and other "welfare" programs.

Still, the underlying message about fiscal limits and the need for policy trade-offs is well-taken. As Clinton's current budget proposal demonstrates, spending programs are coming under closer scrutiny, and many of them are being singled out for reduction or elimination. Assuming that policymakers continue to agree to help the working poor, they will come under greater pressure to justify maintaining or expanding the EITC.

Is the EITC the best way to transfer some $14 billion annually to the working poor? Unfortunately, the government has not sponsored any formal evaluation of the EITC's effectiveness, and studies of the effectiveness of alternative programs (the minimum wage, for example) have sometimes produced conflicting results. The EITC is not alone in this regard: we know precious little about the effectiveness of most tax expenditures.

One can imagine several potentially useful comparisons. Perhaps the most obvious is to a higher minimum wage, which could be even simpler to administer than the EITC. The working poor would automatically receive more income, which would come throughout the year instead of in a lump sum at tax time. The fiscal cost of raising workers' wages would be shifted from the government to employers, thereby freeing up money for other programs.

Alternatively, we could subsidize the working poor directly, through European-style family allowances, rather than indirectly through the tax code. That way, recipients wouldn't have to deal with complicated tax forms, and the IRS would have one less social program to administer. Conceivably, the added simplicity could increase participation rates and decrease error rates. The national government is particularly adept at cutting checks (witness Social Security), so the cost of administering family allowances should be fairly small. And the tax code would have one less loophole, which most economists would favor as sound tax policy.

Finally, one might want to devote more resources to programs that use government subsidies not just to supplement income but to create better paying jobs or improve job skills. If trends over the last two decades continue, the working poor will face stagnant wages and declining opportunities for advancement. Down the road, there could be charges of "EITC dependency." Selective investments in industry and human capital could make the EITC more a transitional program, serving working people on their way up the wage and occupational ladders.

Clearly, one could support both the EITC and one or more of these alternative approaches to raising the incomes of the working poor. For example, the Clinton administration and the Center on Budget and Policy Priorities favor expanding the EITC and indexing the minimum wage. They argue that a higher minimum wage would help those working poor without children who were excluded from the EITC program until this year and who are scheduled to receive a much smaller benefit than families with children.

It is hard to say which combination of these and other programs will prove most effective in helping the working poor. However, people who believe the EITC is good policy doubtless will be pressed to explain why in more concrete terms. No question—the EITC program has provided substantial relief to a segment of the population too long ignored by social policy. Proponents now need to consolidate their gains by defining more sharply what the EITC is supposed to accomplish, continuing to lower administrative hurdles, documenting the EITC's impact, and explaining the program's virtues not only in Washington but to the general public as well.❖

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The Global Hiring Hall

Why We Need Worldwide Labor Standards

Richard Rothstein

Global labor standards may now become a mainstream public issue. NAFTA represents the first time a major trade agreement secures labor rights, albeit minimally. President Clinton may attend the 75th anniversary meeting of the International Labor Organization (ILO) in Geneva this June—a meeting that will consider endorsing the right of industrialized nations to bar imports from nations with little "social progress." Clinton and Jacques Delors, president of the European Union, have suggested that labor and social standards could be the subject of the next round of trade negotiations.

In a world of widespread poverty, high unemployment and integrated markets, global labor standards are necessary to keep the poverty of poor nations from depressing the decent living standards of rich ones. When Third World workers' purchasing power lags their output, they can't afford to consume the fruits of their own production or to buy many exports from the industrial nations. As a result, the employment security and living standards of workers everywhere are dragged down together. For example, Malaysia, with 85,000 electronics workers the world's largest exporter of semiconductors, had no minimum wage law but permitted unionization—except in its electronics sector. So multinational corporations like Texas Instruments, Intel, and National Semiconductor set up shop there to pay young women 45 cents an hour for unskilled production work. The Malaysian American Electronics Industry Society declared that member firms would discontinue investments if unions were authorized. Malaysia found it had little ability to impose standards within its borders, lest investors relocate capital (and employment) to more pliable nations.

Mexico resisted a NAFTA side agreement in part because higher labor costs in Mexico could displace investment and jobs to Guatemala, the Caribbean, and Asia. Competition from nations with lower standards are a permanent brake on any nation's attempt to raise standards (and increase labor costs). Thus, international labor standards must be universal.

In principle, a new trade round could condition free entry to the world's markets on observance of minimum social standards. As a first step, the United States could insist on acceptable minima as the price of easy access to our domestic market.

Good places to begin are child labor and minimum wages. Most labor-rights advocates agree that no child younger than 15 should do factory work. But in the absence of global standards, the use of child labor in

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some Third World export industries (like garment or toy assembly) is tempting because children of desperately poor families will work for even less than the adult subsistence wage. When children are kept in factories, not schools, developing nations undermine their own growth potential by denying themselves a better educated work force. Child labor impoverishes not only present but future generations.

Suffer the Children

Unfortunately, industrial child labor may now be increasing as developing nations compete for export plants with offers of lower and lower labor costs.

■ A *Wall Street Journal* story in 1991 reported that "Underage Laborers Fill Mexican Factories." Featured was 12- year-old Vicente Guerrero, first-ranked in his school but forced to drop out for a $34-a-week shoe factory job where he was poisoned by fumes. Embarrassed by publicity, the firm fired Vicente (with 20 child coworkers), and the *Journal* established a scholarship fund to keep him in school. But some 5 million to 10 million other Mexican children younger than 14 continue to work illegally.

■ The National Consumers League conducts Christmas boycotts of toys made in China. In China's special economic zones, girls as young as 10 sleep in company dormitories and work 14-hour days for as little as $10 a month. Under pressure, China prohibited employment of children in export industries, but enforcement is impractical. When Chinese officials targeted child labor in one 2,600-worker factory, the manager for American toy contractors threatened to close and move to Thailand.

■ Wal-Mart contracted for apparel production in a Bangladesh plant where 300 children younger than 13 worked up to 20 hours a day and slept on factory floors, to earn $7.50 monthly. In response to a 1992 NBC expose, Wal-Mart promised a "vendor certification" plan to eliminate child labor. Yet while Bangladesh has prohibited child labor since British colonial times, apparel factories have now begun to snub the law with impunity. According to official Bangladesh statistics, labor force participation of 10- to 14-year-old girls jumped from 4 percent in 1981 to 15 percent in 1986, as apparel exports doubled annually.

■ Indonesia in 1949 prohibited children under 15 from working. But in 1987, to attract more investment, the country abolished this prohibition for "children forced to work for social or economic reasons." By 1991, there were 2.8 million Indonesian children "bonded" to factories—that is, mortgaged by parents to employers. U.S. Trade Representative Mickey Kantor recently announced that Indonesia would be given six months to improve worker-rights guarantees or lose duty-free preferences in the U.S. market.

■ West German consumer groups now boycott carpets from South Asia. There, children under 14 are mortgaged to factories where accumulating bills for food, lodging, and drugs (amphetamines dispensed to sustain round-the-clock work) makes redemption of the mortgages impossible. According to the ILO, about half the children in Pakistan's export carpet industry die from malnutrition and disease before the age of 12. Nepal had no international carpet industry 30 years ago; by 1988, nearly 600 factories exported carpets. Children under 15 comprise two-thirds of Nepal's industrial work force.

■ Indian manufacturers, reacting to boycotts, recently adopted a label to certify that carpets were not made with child labor. But without assurance of international uniformity, self-monitoring can't succeed. Carpets are now India's biggest export earner, and the industry employs 300,000 child laborers. In Uttar Pradesh, hub of the industry, no employer has yet been prosecuted for a child labor violation despite adequate legislation. India, Pakistan, and Nepal recall how their industries emerged. In 1970 the Shah of Iran banned child labor, prompting the industry's relocation to South Asia. The Shah's ban succeeded only in substituting Asian child

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servitude for that of Iranian children. Labor standards can't work unless they are universal.

Reversing the Spiral

Global agreements or U.S. trade law could increase the pressure to ban child labor. Senator Tom Harkin and Congressman George Brown have introduced a Child Labor Deterrence Act to prohibit the import of products manufactured by workers under the age of 15. But child labor prohibitions cannot themselves stem downwardly spiraling earnings and living standards. With surplus labor pools in most developing countries, and mobile technology and capital, manufacturers need not pass fruits of higher productivity on to adult workers either. Rather, if employees demand rising compensation (either by trade union organization or wage regulation), investors can relocate to equally productive nations where wage demands are less forceful. In addition to international prohibition of child labor, international wage regulation is also needed.

The creation of internationally regulated wage floors is more difficult than regulation of child labor, yet the task may be less difficult than it first appears. There is already adequate U.S. legislation, though it has not been implemented. Former Congressman Donald Pease successfully sponsored amendments to 1980s trade laws, requiring U.S. imports to be manufactured with respect for "internationally recognized worker rights." Pease amendments generally require developing nations to assure the right of association, the right to bargain collectively, protections against forced labor, a minimum age for employment of children, and acceptable conditions regarding minimum wages, hours of work, and health and safety. For "acceptable conditions regarding minimum wages," Congress proposed that definitions vary with nations' levels of economic development.

Pease amendments are included in the Caribbean Basin Initiative, the Generalized System of Preferences, the Overseas Private Investment Corporation, Section 301 of the Trade Act, instructions for U.S.-designated executive directors of the international financial institutions like the World Bank, and foreign aid appropriations. However, enforcement has been weak. The United States did require several Caribbean Basin countries to improve minimum wage enforcement. Haiti, for instance, had to begin weekly radio publicity about labor code protections and commit that workers reporting minimum wage violations would not be punished. But the Reagan administration mostly used worker rights as a political tool, denying, for example, duty-free status to Romania and Nicaragua, while ignoring labor-rights violations by major developing nation exporters. The warning just given Indonesia is one of the strongest yet, though like most enforcement actions, it focuses primarily on denials of the right to organize, with little reference to failures to enforce acceptable minimum standards.

In effect, the Pease amendments made "acceptable minimum wages" U.S. policy, but the executive branch has declined to propose regulations defining acceptable rates consistent with nations' development levels. But the Pease amendments can be made into meaningful policy.

Consider the example of the Bangladesh garment industry. A mid-1980s study found that U.S. workers manufactured a men's shirt in 14 person-minutes, while in Bangladesh, one men's shirt included 25 minutes of labor. U.S. apparel workers' earnings averaged $7.53 per hour, while hourly Bangladesh garment wages averaged 25 cents. Thus while the U.S. industry enjoyed nearly a 2 to 1 productivity advantage, Bangladesh had a 30 to 1 wage advantage. A shirt's unit labor cost was $1.76 in the U.S. but only 10 cents in Bangladesh.

If capital were not so much more mobile than labor, organized Bangladesh garment workers could demand wages approaching $4.22 per hour, which, based on their

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productivity, would generate a comparable Bangladesh shirt unit labor cost of $1.76 (This simplified illustration leaves aside other cost differences like shipping, real estate, or power.) So if Bangladesh labor could freely compete against U.S. garment workers, wages would be higher and adults could displace children in shirtmaking. Bangladesh now fears to use its growing productivity to improve its labor standards, however, because if it attempted to do so, investors might flee the country.

Minimum wages are broadly related to average wages. In low-wage, labor-intensive industries, minimum rates influence average wages directly. This is not only because many workers are directly affected by minima but because minimum increases tend to push up other wages as employers preserve intra-firm differentials, raising rates of higher paid workers. Usually, when minima are raised because of legal requirements, both here and abroad, there is an initial period of wage compression before differentials are gradually reestablished. For similar reasons, wage averages in higher paid industries may be affected indirectly by minimum increases.

At the time of our mid-1980s Bangladesh illustration, the U.S. minimum wage was $3.35, 44 percent of average apparel wages. If policy postulated a similar relationship between minimum and average Bangladesh apparel pay, an acceptable minimum for Bangladesh's garment industry should have been $1.88 (44 percent of $4.22), were wages taken entirely out of competition.

So far, this $1.88 "acceptable" minimum wage calculation is a consequence only of relative labor productivity—it makes no adjustment for Bangladesh's early economic development stage. But such an adjustment is needed to satisfy the Pease amendments' essential concern that minimum standards be appropriate to nations' income levels. For this purpose, policy could broadly categorize Third World nations by income bands, with poorer nations granted greater concessions.

For example, nations with per capita GNP between $2,500 and $5,000 (like Mexico) might be granted a 20 percent concession from minimum wage rates calculated from leveled unit labor costs alone. Nations with per capital GNP from $1,000 to $2,500 (like Jamaica or Poland) might be granted a 40 percent concession; from $500 to $1,000 (like Indonesia or the Philippines) a 60 percent concession; and countries with less than $500 (like Bangladesh) might be given an 80 percent concession, expecting Bangladesh's minimum wage to be only 20 percent of the $1.88 needed to level unit labor costs. If, then, the additional step were taken of granting, say, a five-year period to achieve this minimum, Bangladesh could be advised that, five years hence, exports to the United States will be permitted only if they are manufactured by workers earning a minimum of 38 cents an hour, a substantial but not impractical increase.

Most Third World governments are hostile to child labor prohibitions and minimum wage regulation.

If we make similar calculations for Mexico, and assume that labor productivity in garment export industries was 65 percent of U.S. productivity in the mid-1980s, we could posit an acceptable minimum wage for Mexican export industries of $1.74—about three times its current level. This is not unlike what Mexico's minimum would have been had minimum rates been increasing with productivity (now growing at about 6 percent a year). In light of President Salinas's announcement that Mexican minimum wages should henceforth increase with productivity, requiring such a minimum, in gradual steps over several years, is entirely reasonable.

These figures are only illustrative, suggesting results that rigorous U.S. rulemaking might produce. This interpretation of Pease requirements would spur substantial

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increases in Bangladesh workers' purchasing power, without eliminating Bangladesh's opportunity to use its low-wage "comparative advantage" to attract investment. Concrete definitions of acceptable minimum rates, calculated for all our low-wage trading partners, could begin to reverse downward international spirals and stimulate rising wages of industrial nation and Third World workers in response to expanding markets and growing demand.

As an alternative approach, "acceptable" minimum wage levels might be estimated by examining the shares of the value-added in manufacturing that workers in various countries receive as earnings. Such calculations would address directly the excessive profits earned by First World importers on Third World labor exploitation. Other policy questions raised by our illustration include:

- Is it justifiable for Pease amendment interpretation to calculate acceptable minimum wages in U.S. dollars rather than Bangladesh taka? Perhaps so, since the purpose is to regulate U.S. market participation and to guide how developing nations can compete for access to that market without exacerbating the downward spiral. But categorization of nations based on income bands, for purposes of granting concessions, is a different matter. These categories should probably be established using per capita GNP not in exchanged dollars but in "purchasing power parity" dollars (which the IMF now calculates).
- Should calculations establish different acceptable minima industry by industry? Many nations have minimum wages which differ by industry, but if the goal is a process which is simple and transparent, such complexity by U.S. import control agencies should probably be avoided.
- Should these calculations be reviewed periodically as the U.S. minimum wage is adjusted and as the per capita incomes of various developing nations improve? Probably so.

An altogether different method might disregard unit labor costs and define acceptable minima for various nations based on a worker's cost for a typical "market basket" of food and other necessities. Perhaps the World Trade Organization (GATT's successor) should adopt this approach, but its apparent justice may hide complexities (like determining how many dependents a single minimum wage should be expected to support) more daunting than the unit labor cost method sketched above. While questions remain, the point of this exercise is to show that transparent wage rules can be established that take account of countries' wide-ranging levels of development. These rules are not "protectionist," are easier to implement than judgments about whether other legal systems afford meaningful rights to collective bargaining, and can potentially help reverse the international downward wage spiral. Most important, if such a regime enjoyed uniform international enforcement, no developing nation need fear loss of competitive advantage because neighbors were more willing to attract investment by undercutting universally accepted labor standards.

Prosperity Through Impoverishment

Most Third World governments and international development experts, reflecting conventional economic wisdom, are hostile to child labor prohibitions and minimum wage regulation. They consider such rules "protectionist"; they believe that labor exploitation is inherent to development, that wages rise as productivity increases, and that child labor disappears as national incomes grow to make schooling affordable.

Bangladesh officials now complain, for example, that prohibiting child labor could "force thousands of child workers into begging or prostitution." UNICEF's Bangladesh representative declared that the prospect of the Harkin-Brown amendment "has already done damage to children by evicting them from garments manufacturing facilities and depriving them of in-

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come." Dhaka social workers told the *Bangkok Post* that "50,000 children, mostly girls, could be left out of work and pushed into a life of crime" if Harkin-Brown passed.

Yet there is no evidence that labor standards necessarily improve with development. In Third World countries, IMF-inspired macroeconomic policies and competition for footloose international capital make real wages more likely to fall than rise with productivity gains. Many developing nations have deliberately suppressed wages and relaxed child labor rules in recent years, so unit labor costs fall even faster than productivity rises. From 1980 to 1989, Mexico's real manufacturing wages fell by 24 percent while industrial productivity (gross output per employee, including national and export-oriented industries) increased 28 percent. In Bangladesh, productivity grew by 20 percent, but wages did not rise.

In the *Harvard Business Review* last year, World Bank consultant David Lindauer reflected the development establishment's consensus apology for child labor:

> If [children] were not in the factory, they might be separated from their mothers and working as maids, or at home on consignment, or in local [non-exporting] carpet factories. Even worse, they might be begging or scavenging . . . .
>
> [We] cannot solve the problem of child labor in a poor country by prohibiting . . . contractors from hiring anyone under the age of 14 . . . It will not change the fundamental circumstances of the . . . labor market. . . .
>
> When wages and household incomes rise, families can afford not to require their children to work (or accompany their mothers to work). . . . With rising wages, companies also will be less likely to employ children. . .
>
> We know of no case where a nation developed a modern manufacturing sector without first going through a "sweat shop" phase. How long ago was it that children could be found working in the textile factories of Lowell, Massachusetts, of Manchester, England, or of Osaka, Japan? Should the developing countries of today be any different?

These arguments differ little from rationalizations by academic and industrial authorities in defense of Lowell sweatshops earlier this century. According to one mill owner's 1916 congressional testimony: "If you raise the limit to 15 or 16 you would simply exaggerate to a much larger extent the hardship that would be visited upon large numbers of people through the country who have had to contend with adverse conditions and upon whom God has laid poverty." Today's World Bank only substitutes for a deity the "fundamental circumstances of the labor market."

Conventional development theory assumes that child labor cannot reduce incomes because adults are more productive, so employers don't hire children unless adult workers command higher wages elsewhere and so are unavailable. If children work in the market economy, therefore, they cannot displace adults or drive down their wages; rather, family poverty must force children into factories to supplement household income.

Today's apologists for child labor—the IMF, the World Bank—sound no different from the defenders of sweatshops nearly 80 years ago.

This full employment assumption is fantasy. Claims that industrial opportunities for children protect them from worse fates are true for individual children only in the absence of uniform child labor prohibitions

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that open opportunities for their parents to earn a living wage. During the Great Depression, we recognized that child labor did not alleviate poverty but perpetuated it, because children worked while adults were unemployed. Adults could work only for pay sufficient to support families at subsistence, but children worked for less.

Where child labor is prevalent, it accompanies substantial adult unemployment. In Mexico, where 12 percent of children work, the official adult unemployment rate is only 2.9 percent, yet anyone working a minimum of one hour weekly, even informally, counts as "employed." Only 56 percent of Mexico's 24 million person labor force works for legal companies or government. Thus as many as 10 million Mexican adults may be seriously underemployed, equal to the number of children working.

Academic hostility to international labor standards also stems from failure to consider the induced capital-labor substitution, better training, and reduced turnover that higher standards permit. Instead, experts almost always predict that even modest minimum wage increases create unemployment and (for both the United States and developing nations) often are proved wrong. The simplistic notion that the cheapest labor is most efficient was disproved in the antebellum South, when

Labor Rights at Home

The assumption that global regulation might prohibit child labor and establish organizing rights, but not raise wages, ignores our own history. New Deal legislation established labor standards for domestic regions that were also at different development stages. Granted, income differences between First and Third World nations are much greater, and no one suggests a uniform international minimum. Today we need a more complex international standards regime, but this is no reason to fear the endeavor.

New Deal reforms supported worker incomes and retarded (without prohibiting) relocation of investment from high-wage to low-wage regions. Northeastern representatives recognized they could not ban child labor and require minimum wages if southeastern states lured industry with the absence of these rules. So the Fair Labor Standards Act (FLSA) of 1938 kept children younger than 16 from factory work and mandated minimum wage payments.

Federal legislation did not require states to protect collective bargaining, prohibit child labor, or require minimum wages in "domestic" intra-state enterprises. Rights and standards were imposed only for participants in interstate commerce: exporters to, or importers from, another state. We too easily forget this: virtually all domestic commerce now has an interstate character and the National Labor Relations Act and the FLSA are nearly universally applicable. But as late as 1959, one-third of all nonsupervisory workers were excluded from minimum wage coverage because their firms, not engaged in interstate commerce, could not unfairly compete with other regions.

Similarly, a global New Deal need not dictate requirements that developing nations protect worker rights or standards in their purely domestic economies. These requirements should apply only to industries that export to other nations or produce significant quantities of parts or services incorporated in exports. Thus as the "state's rights" objection was met domestically, complaints can be dismissed that international labor regulation infringes on sovereignty to regulate purely domestic conditions.

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plantation owners feared to entrust slaves with adequate tools because their use required training, self-direction, and motivation—attributes inconsistent with slavery. Twentieth century studies of Third World workers find that productivity increases when workers' pay grows to purchase the minimal caloric intake needed to perform adequately. In such circumstances, however, the productivity payoff is more distant than immediate costs of higher minimum wages, so only uniform international enforcement can induce employers to make the necessary investments.

In the United States, industrial wages began to increase and child labor was abolished, not as the evolutionary consequence of development, but after decades of bitter political conflict. (See the box, "Labor Rights at Home.") A law prohibiting factory child labor was enacted in 1917 and declared unconstitutional by the Supreme Court. A second law taxing profits from child labor was also invalidated. Industrial codes of the New Deal's National Recovery Administration prohibited child labor; these were also struck down. In 1938, following 30 years of popular agitation, a tamed Court accepted the Fair Labor Standards Act, which prohibited factory child labor and enacted minimum wages.

There is, in short, neither contemporary nor historical evidence that an upward spiral naturally evolves. Some cite Korea as a nation where wages and thus consumption began to rise as industrialization matured. But worker rights did not evolve in Korea; they were seized in bloody street riots and a political revolution deposing military dictatorship.

All of these issues are finally on the global radar screen. President Clinton apparently wants to place a "global New Deal" on the international agenda. NAFTA's token labor agreement drew mostly contempt from labor rights advocates, but NAFTA was nonetheless the first trade agreement to legitimize international labor regulation. French leaders President Francois Mitterand, European Union President Jacques Delors, and Prime Minister Edouard Balladur now propose that access to European markets be conditioned on higher Third World wages. In January Mickey Kantor told EU External Affairs Minister Sir Leon Brittan that a post-Uruguay round of negotiations was needed on international labor standards. The following day, Clinton met with Delors. In a Brussels press conference, Clinton reported, "I suggested that the successor agenda to the Uruguay Round should include . . . labor standards. . . . If we're going to open our borders and trade more and invest more with developing nations, we want to know that their working people will receive some of the benefits. . . . Otherwise, they won't have increasing incomes, and they won't be able to buy our products and services."

Clinton's comments created controversy in Europe but went unreported at home. Sir Leon criticized American proposals as "a disguised form of protectionism," merely "fashionable and politically correct," but a month later, the European Parliament proposed including labor laws in the General Agreement on Tariffs and Trade. Clinton then reportedly accepted an invitation to attend in June the 75th anniversary Geneva convention of the International Labor Organization.

Whether multilaterally through the GATT, or unilaterally by enforcement of Pease or Harkin-Brown standards, policies to enforce acceptable minimum wage rates and prohibitions on child labor in developing economies' export sectors are appropriate and necessary. Such policies will retard the competitive gyre, where wages in all nations decline as each bids against the other for investment. Higher labor standards will encourage developing economies to invest in education, training, and technology to assure greater returns for labor investments. And higher standards will contribute to growth of worldwide final demand, so that both developing and industrialized nations have opportunities to pursue full employment policies.❖

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Secret Justice

When National Security Trumps Citizen Rights

Frank Askin

> *"The proceedings were not only kept secret from the general public, but from the accused as well. . . . For even the accused had no access to the Court records, and to guess from the course of an interrogation what documents the Court had up its sleeve was very difficult."*
>
> —Franz Kafka's description of Joseph K.'s ordeal in *The Trial*

CIA agent Aldrich Ames, accused of selling top-secret intelligence to the Russians, has made an ominous threat. According to his lawyer, Plato Cacheris, Ames's defense will try to force the government to divulge even more sensitive intelligence during a potential trial. Something of the same gambit was tried by Oliver North in the Iran-contra affair.

This tension between the right of the accused to a fair trial and the state's need to protect legitimate secrets is all too real. Yet there is a troubling pattern in a series of recent civil cases that suggests an opposite abuse: in more obscure cases, government is often able to hide behind a national security cloak and deny a fair, public trial to ordinary citizens who are abused by the national security apparatus. Apparently, the big fish like Oliver North and Aldrich Ames, who know big secrets, are often able to escape accountability by threatening to tear down major chunks of the national security edifice. Meanwhile, smaller fry, who have fewer beans to spill, get the star chamber treatment.

Just ask Daniel Molerio. Molerio wanted to be an FBI agent and was well on his way to becoming one in 1980. As a criminal investigator for the Immigration and Naturalization Service, this son of Cuban immigrants had already proven himself in the field and had earned the unit's "secret" security clearance. When Molerio scored high on the FBI's entrance exam and interviews, the bureau ranked him fifth in a list of 785 applicants tentatively selected to be secret agents. All that remained was the background check. The FBI told Molerio they would be in touch.

But the next call from the FBI was not a congratulatory one. Agents had found "something in New York having to do with [his] family." They interviewed him again, this time asking questions about his father's involvement with a pro-Castro group many years before. On November 20 the FBI told Molerio he would not be hired. The bureau would not give a reason, but Molerio had a hunch: he was being discriminated against because of his father's past political association.

Maybe the FBI had a valid reason not to hire Molerio. Maybe Molerio was correct in his suspicions. Who knows? Molerio, like

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Joseph K. in *The Trial*, never got a chance to find out. In 1982, when Molerio sued for violation of his rights under the Civil Rights Act and the First Amendment, a federal trial court dismissed the case after receiving secret testimony from the bureau. When Molerio took his case to a federal court of appeals, citing his due process right to confront testimony delivered against him, Judge Antonin Scalia sided with the lower court. To let the jury rule on this case would be a "mockery of justice," Scalia huffed. It would have forced the government to either compromise national security or lose a case for which it had a perfectly good defense, Scalia said.

Federal courts had previously upheld the government's right to withhold classified information during hearings, albeit in very limited circumstances. But Scalia's willingness to decide the merits of a case based on secret testimony was unprecedented. The *Molerio* decision flew in the face of a constitutional tradition that revered both the right to a jury trial and the right of litigants to contest hostile evidence in an adversary proceeding. The fact that other judges have since followed Scalia's example is a reminder that 12 years of conservative court-packing has bequeathed us a judiciary dangerously cavalier about our most fundamental rights.

National security need not be sacrificed in the name civil liberties. Instead, when the government claims evidence relevant to a litigant's case is classified, it should be required, by law, to make a choice between divulging the information at a closed hearing or doing without the evidence, even at the cost of accepting a judgment for the litigant. Given the government's proclivity for overclassification and the potential for abuse inherent in any suspension of due process, that would be a better, if admittedly imperfect, means of protecting both national security and the rights of citizens.

Case Dismissed

Since the Molerio case, there have been at least four more federal court decisions aborting lawsuits for the sake of government secrets.

Todd Patterson was a precocious 11-year-old when he began to compile a world encyclopedia by writing foreign governments for information. The next year, the FBI visited his house to learn why he was corresponding with communist countries. In 1988, when Patterson was 15, and the FBI refused to let his parents see what kind of records it was maintaining about Todd, the family sued to expunge Todd's files under the Federal Privacy Act. The Privacy Act forbids the FBI from maintaining files detailing how an individual exercises rights protected by the First Amendment, such as writing letters, unless pursuant to an authorized investigation.

The trial judge initially agreed that on the basis of the public record the FBI could not justify maintaining records on a curious teenager. However, after the FBI submitted a secret affidavit to the court, the judge dismissed the case. He said that for reasons that had to be concealed from Todd and his lawyer, he was satisfied that the FBI was acting within its authority. The judge assured Todd and his family that they had nothing to worry about. Nothing the FBI had told him reflected badly on Todd.

Wabun-Inini left some film for processing at a one-hour photo store. A few minutes later, an FBI agent entered the store and told the clerk he wanted to buy a set of the photographs. The clerk consulted the night manager, who finally agreed to sell the agent copies of the prints for 19 cents a piece. Wabun-Inini sued, claiming an illegal seizure of his property as well as an invasion of his political privacy. As in Todd Patterson's case, the court decided on the basis of a secret FBI affidavit that the FBI had proper cause for obtaining copies of the plaintiff's photographs. Only the FBI and the judges know what those reasons were.

The crew of the U.S.S. *Stark* ran into a related problem. Thirty-seven members of the crew were killed in 1987 when the ship was hit by two Iraqi missiles in the Persian Gulf. Survivors of the dead sailors at-

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tempted to sue General Dynamics and several other defense contractors, alleging that production defects in the *Stark*'s defense system had led to the deaths and injuries. Like Molerio, Todd Patterson, and Wabun-Inini, they were denied trials on the grounds that public hearings would disclose state secrets.

Robert J. Maxwell had the most bizarre experience of all. He sued the First National Bank of Maryland for constructive discharge after he refused to assist an illegal arms transaction by a bank customer whom he determined to be a CIA front. Maxwell claimed he was so threatened by the CIA for his resistance that he became ill and had to leave his job. A federal judge in Maryland not only prohibited Maxwell from questioning his bank employers about the CIA relationship but indicated that Maxwell could not testify as to his own personal knowledge of the customer's status and the events surrounding the loss of his job.

Even if the government ultimately deserved to prevail in these cases, the fact that these citizens never got trials represents an injustice all its own. If we don't allow citizens with grievances to pursue remedies in the courtroom, how do we ensure those who are wronged will receive justice? As Chief Justice John Marshall declared in *Marbury v. Madison*, citing common law tradition and Blackstone's *Commentaries*, the entire legal system could crumble "if laws furnish no remedy for the violation of a vested legal right." Preserving the right to a trial is particularly crucial when the government is a party to legal action, for if there is one fear the framers of the nation's legal system shared, it was a fear of despotism.

Granted, were national security truly at stake, these transgressions might be understandable, if not forgivable. History suggests, however, that when an administration or government agency invokes the cause of secrecy, it often does so to protect its political interests or reputation—not national security. That was the lesson of the *New York Times Co. v. United States*, the so-called Pentagon Papers case in which the government sought to suppress publication by the *Times* of confidential Rand Corporation documents on the Vietnam War. The government, represented by Solicitor General Erwin Griswold, had said publication of the papers would seriously jeopardize national security. When the *Times* prevailed and published the documents, government integrity proved to be the only casualty. Years later, Griswold conceded the purported risk never existed:

> It quickly became apparent to anyone who has considerable experience with classified materials that there is a massive overclassification and that the principal concern of the classifiers is not with national security, but rather with governmental embarrassment of one sort or another. . . . There is very rarely any real risk to current national security from the publication of facts relating to transactions in the past, even the fairly recent past.

I once litigated a case in which the FBI had been tracking all the mail to and from a fringe socialist organization. My client, another high school student, had written to the organization as part of a civics assignment for class. When the FBI intercepted one of her letters and conducted a field investigation on her, she sued, claiming an unlawful invasion of privacy and infringement on her First Amendment rights. The FBI claimed that its investigation of the organization—and thus its investigation of my client—was justified on national security grounds but refused to divulge the basis for it.

For five years, a federal judge upheld the FBI's claim that the document authorizing the mail cover was privileged and that making it public would harm national security. The case languished. Finally, it was serendipitously transferred to a new judge who ordered disclosure of the document.

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That disclosure revealed that the only reason for the mail cover was that the organization was involved in protests against the Vietnam War. The judge ruled the FBI's mail cover unconstitutional.

In an ideal world, some impartial arbiter could determine on a case-by-case basis whether government secrets warranted suspending due process. But this is not an ideal world, and there is no such thing as an impartial arbiter—that is why the Constitution commands due process of law. In Molerio's case, Scalia said society must simply trust judges to do the right thing. But judges, as Justice William Brennan once observed, "are human beings whose judgment necessarily reflects the press of human events."

Americans learned this lesson firsthand after decades of arbitrary British colonial rule. While common law guaranteed jury trials to British subjects, it did not apply to the colonies. That is why the Founders wrote the jury trial guarantee into the Bill of Rights. As Justice Byron White, a man known as neither a great liberal nor an enemy of the political establishment, noted some two centuries later:

> Those who wrote our constitutions knew from history and experience that it was necessary to protect against. . . judges too responsive to the voice of higher authority. The framers of the constitutions strove to create an independent judiciary but insisted upon further protection against arbitrary action. . . . The jury trial provisions of the Federal and State Constitutions reflect a fundamental decision about the exercise of official power—a reluctance to entrust plenary powers over the life and liberty of the citizens to one judge or to a group of judges.

Unprecedented Violations

The primary precedent for *Molerio* and the other decisions was a 1953 high court ruling, which involved the deaths of three civilians in the crash of a military airplane that was testing secret electronic equipment. When the government refused to turn over to the plaintiffs a report of its investigation of the accident, the district court ordered that the facts on the negligence issue be considered established in the plaintiff's favor. In *United States v. Reynolds*, the Supreme Court reversed by a six-to-three vote and created an "official secrets" privilege that precluded the discovery of confidential government information by parties to a civil lawsuit. However, the decision did not prohibit the plaintiffs from pursuing their case if they could produce unclassified evidence to support their claim.

Some judges have also cited a Civil War lawsuit, in which a Union spy named William A. Lloyd sued the government, claiming he never received compensation. The Supreme Court threw out Lloyd's suit because of the secret nature of the agreement. Because of the publicity it would generate, the Court said, the suit would constitute a breach of the espionage contract.

The crux of *Lloyd* was an assertion that "as a general principle, public policy forbids the maintenance of any suit . . . which would inevitably lead to the disclosure of matters which the law itself regards as confidential." The Court likened the forced disclosure of a spy agreement to breaches of lawyer-client or doctor-patient confidentiality, which are generally prohibited.

Fair enough. But the Civil War was an extraordinary time when the courts routinely tolerated suspension of civil liberties because the nation's very existence was in jeopardy. Even if the circumstances of the Cold War were analogous, it's questionable whether *Lloyd* should have such far-reaching implications. Neither *Lloyd* nor *Reynolds* ever suggested that lawsuits could be resolved on the basis of secret evidence.

Prior to Scalia's ruling in *Molerio*, government lawyers had unsuccessfully attempted on several occasions to introduce secret evidence in federal trials. In *Kinoy v. Mitchell*, a 1975 civil suit brought against

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former Attorney General John Mitchell for wrongful wiretapping, the government asked to submit evidence it could not share with the plaintiff—evidence it said was vital to national security. A federal trial court would hear nothing of it, ruling that such a tact was a "wholly unacceptable" violation of due process. In *Allende v. Schultz*, a 1985 case, a federal court again prohibited the government from providing secret testimony to justify its denial of a visa to an allegedly undesirable alien, the widow of the martyred Chilean president, Salvador Allende. If the government wanted to submit relevant evidence, the court said flatly, the government had to make that evidence public. The government capitulated, and Hortensia Allende got her visa.

Interpretation of precedents can vary, of course, but that is precisely the point. Judges are human. They have biases. That is why our legal system does not place complete faith in the judge. It requires due process.

Overdue Process

Despite the entrenchment of conservatives in the judiciary, undoing this legacy need not be difficult. The Clinton administration has already taken the first step by pledging to declassify many of the billion-plus documents in the government's archives. The administration has also appointed several task forces on purging the vestigial accoutrements of the Cold War.

Yet even if the administration manages to tame the national security behemoth, classified information will remain. Bureaucrats will continue to claim that disclosures might compromise national security—particularly in suits against law enforcement agencies.

Congress, though, still makes the law, and it has already provided a mechanism, the Classified Information Procedures Act, for protecting government secrets while allowing litigation to proceed—at least in criminal cases. CIPA was adopted in 1980 to frustrate criminal defendants' efforts to "blackmail" prosecutors by threatening to reveal classified information in the course of their defense. Rather than compelling the government to dismiss charges in order to protect secrets, the legislation provides for judicial review of the material to determine whether the information is relevant to the defense and whether the defendant's rights can be protected without compromising legitimate government security interests. If the court determines disclosure of classified information is essential to the defense, the government then faces a choice: release the information or dismiss the charge.

This is the provision Aldrich Ames hopes to use. Of course, there is an important practical difference between cases subject to CIPA and civil litigation against the government. CIPA defendants are invariably government agents who are already privy to the allegedly sensitive information. They and their lawyers have access to the same information available to the prosecutors and can argue the merits of the government's claims and the sensitivity of the information on an equal footing. On the other hand, civil litigants faced with government claims that sensitive information trumps the plaintiff's rights are forced into a game of blind man's bluff.

In 1981, a federal judge took a CIPA-type approach to deal with secrets in civil cases. The family of a murdered civil rights worker, Violet Liuzzo, had sued the FBI, claiming an FBI informant had participated in the killing. The government claimed that a relevant FBI report was privileged and ought not be revealed. Since the judge, Charles Joiner, found that the plaintiffs had presented the court with "a case which is neither frivolous nor beyond belief," he would agree to suppress the report only on condition that a judgment of liability be entered against the government. As in the criminal context, the government was not permitted to protect its secrets at the expense of its adversary.

Although the Federal Advisory Committee on the Rules of Evidence endorsed this approach, no judges have followed

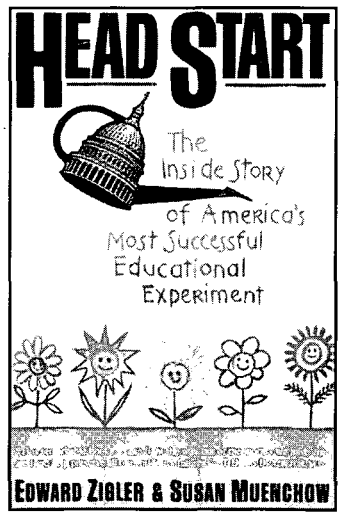
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Judge Joiner's example. Congress, meanwhile, declined to adapt CIPA for civil cases when it adopted the Federal Rules of Evidence in 1975. The main objection to the remedy is that an undeserving litigant may occasionally walk away with a windfall. But that seems like an acceptable trade-off, particularly when so many government claims of national security turn out to be specious.

Besides, the remedy need not be so heavy-handed. For example, the courts could offer the government the option of a closed adversarial hearing rather than an open public trial. True, this would require sharing the classified information with the litigant's attorney, but such procedures are not unprecedented. Lawyers, as officers of the court, often receive confidential information under protective order forbidding disclosure to outside parties. Few lawyers would risk losing their licenses by violating such orders. Offering closed hearings might not be a perfect solution. It would require some litigants to waive the right to a jury trial, and it might even require some lawyers to withhold information from their clients (thus creating a messy conflict of interest). But it would certainly be better than no trial at all.

In the meantime, the Clinton administration could simply instruct its lawyers not to make such secrecy claims. Even when government lawyers feel compelled to assert privilege, they can negotiate settlements or agree to fair procedures. There is no report of a government lawyer having invoked the *Molerio* doctrine since Clinton came to power, and that is certainly a good sign—as is the appointment of committed civil libertarians to posts on the federal bench. Indeed, after three nearly uninterrupted decades of conservative court-packing and expansion of the national security state, the arrival of a liberal administration offers hope that the obsolete violations of due process born in the Cold War may finally be retired as relics.❖

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The Predators' Accomplice

How High Theory Abetted Speculative Excess

Louis Lowenstein

You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right.

Benjamin Graham

In the 1980s some things went right on Wall Street but much went wrong. The fallout is still being felt today. Prudential Securities, which once boasted that "the most important thing we earn is your trust," now apologizes for having systematically duped many of the hundreds of thousands of investors who bought its limited partnership deals. Carl Icahn boasted of having bought TWA; but leaving none of his own money there, he succeeded only in leaving the flying public with 20-year-old aircraft and poor service. Banks and insurance companies bankrolled so many new buildings that we will not work off the excess until the end of the century, if then. As we close the books on the worst era in modern U.S. financial history, Prudential at least has the resources to make amends. The victims elsewhere must often grasp at straws.

This is a good time for a postmortem. It is not widely recognized, but scholars played an important role in the debacle, providing ingenious free-market theories to justify some of the worst excesses. One such concept, "efficient market theory," contributed to the damage then, and in its various mutations continues to do so today.

Even if you're not a student of financial economics, the phrase "efficient market theory" sounds right. After all, the stock market *is* crudely efficient; markets set the minute-to-minute value of stocks, the spreads between bid and asked prices are very small, and commissions are as little as two cents per share.

Efficient market theory (EMT), however, posits something more radical. The principal version, and the one on which this indictment will focus, states that we can trust the pricing of stocks. Supposedly, competition among sophisticated investors enables the stock market to price stocks "accurately"—that is, in accordance with our best expectations of companies' long-term prospects. (The trading by nonprofessionals is said to be random and of no net effect.) Supposedly, all relevant publicly available information is analyzed by investors, and new data, such as an earnings release, are quickly noted, digested, and then reflected in the share price.

In short, stock prices, while not perfect, are as perfect as can be. There are no better estimates of the fundamental value of a company and no systems for beating the market. A corollary is that while the wisest of us can do no better than to buy the market

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as a whole, the rest of us can do far worse.

EMT rests on several controversial assumptions, the most striking of which is the terribly convenient but circular assumption that mispriced stocks cannot long exist because if they did, "smart money" investors and arbitrageurs would already have eliminated them. This when-all-else-fails assumption, so central to the theory, is also the source of the well-worn joke about two economists walking across campus who spy what looks like a $20 bill. As the younger economist leans forward to examine it, her older colleague admonishes her: "If it really were a $20 bill, someone would already have picked it up."

Given the assumption that patience and intelligence are of no consequence, even a super-investor like Warren Buffett should not be able, certainly not with any consistency, to find loose money lying on the table. In fact it is a waste of his time to look.

The defendant, EMT, is hereby indicted. The indictment is limited to four counts. EMT, we shall see, is guilty of:

- Providing the intellectual cover for the excesses in junk bonds and takeovers in the 1980s, ignoring the mounting evidence that important sectors of the economy and innocent bystanders were in jeopardy;

- Encouraging investors to indulge the fantasy that they can "trust prices" to balance risk and reward and thereby save themselves the enormous bother of analyzing actual businesses;

- Aiding and abetting the efforts of the Business Roundtable and similar interest groups to strip voting and other fundamental shareholder rights from stock ownership and have them treated as saleable bits of private property; and

- Justifying a theory of dividend policy that encourages wasteful corporate investment and expansion.

The result is that our financial markets have become increasingly desocialized, shuffling bits of paper and computer analytics in response to their own internalized signals, with too little regard for the real companies, workers, and products that are their reason for being. As in the usual indictment, the prosecution intends to show that the damage has been heavy and that it has been recklessly or even willfully inflicted. After the defendant has been tried, and as I expect, found guilty, we will consider the motives. They will affect the sentencing. But more of that later on.

Count 1: Promoting the "market for corporate control."

For financial economists, the merger boom of the 1980s was the stuff of dreams. Ever since 1932, when Adolf Berle and Gardiner Means first described the separation of ownership and control in the modern, publicly held corporation, observers had wrestled with the dilemma that corporate democracy did not work, that these dispersed shareholders had very limited power, and that corporate managers were able to avoid any serious oversight or discipline. Then at the beginning of the 1980s, there blossomed a shiny new economic model, affectionately called the market for corporate control, which saw the emerging takeover boom as a natural selection device for replacing the poor performers. It is an appealing model. Given an efficient stock market, of which few economists then had any doubt, poor managerial performance would drive down a company's stock price to the point where it would pay a more talented group to bid a substantial premium for control, fire the incumbents, and run the firm themselves. Indeed, in a market as efficient as the one in the model, there could be no other systematic reason for takeovers.

Glory be, the merchants of deals on Wall Street could scarcely believe their ears. Long vilified on Main Street, they were now heralded all across the scholarly landscape—and by high government officials trained by scholars—as the avenging angels of economic revival. Academics, in

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turn, who had never before seen their theories played out on a trillion-dollar scale, were quite prepared to testify that all of this would improve the efficiency of American industry.

In the hot summer of their triumph, scholars and their converts—none of them baptized more thoroughly than Ronald Reagan's Council of Economic Advisers as seen in their 1985 annual report—ignored the perverse incentives and palpable imperfections that drove this market, eventually to wild excess. The story has been widely told in its several variations, but the basic system for takeovers and leveraged buyouts worked like this. Take a not-too-glamorous business, but one with decent prospects, and buy it with as much borrowed money as the banks will lend. As the market heated up, however, even these standards deteriorated. The investment by the new owners became hard to find, and under the pressure to make ever more deals, the prices became absurd. Structured with no room for a disappointment of any kind, these takeovers left many viable businesses—typically household names—and once-loyal workers and communities on the dole. The business casualties—the walking wounded as well as the outright failures—were staggering. (See box.)

How did it happen? EMT provided the justification. In an efficient market, one in which the stock market could not undervalue corporate assets in any meaningful way, efficiency and productivity enhancement justifies takeovers. While this was somewhat obscured by euphemisms, such as that the takeover market is one where managers "compete for the right to manage resources," the basic implication was that higher bidders can manage assets better and that the higher share price is the measure of the prospective improvement.

On a modest scale, hostile takeovers are not a bad idea, but even at the time the gaps in the theory were evident:

- If target company managements were not striving to do the best for *their* shareholders, how sure could one be that bidder managements were doing so for their own? (Indeed the history of the already failed conglomerate era should have raised doubts.)

- The extraordinary availability of borrowed money was soon allowing promotional buyers, with no operating experience and few resources of their own, to acquire major industrial and commercial enterprises.

- The tax gains generated by the substitution of debt for equity—the elimination of the corporate income tax—alone accounted for a substantial portion of the "value" being

Real Casualties of Market Theory

Ames Department Stores
Carter Hawley Hale
Centrust Savings and Loan
Continental Airlines
Federated Department Stores
Fruehauf
Grand Union
Harcourt Brace Jovanovich
Interco
Integrated Resources
Kindercare
Lincoln Savings and Loan
R.H. Macy
Memorex/Telex
National Gypsum
Ohio Mattress
Revco Drug
SCI Holdings
Seaman's Furniture
Southland
Southmark
Telemundo
Texas Air International
Trans World Airlines
USG (Gypsum)
Jim Walter Corporation
West Point Pepperell
Zale

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created in these buyouts.

- There were many bids for only well-managed targets, not just for the laggards assumed by the model.

- The premium prices being paid by bidders, averaging at times as much as 80 percent over the prevailing price in the market, should have raised concerns as to the likelihood of such consistently large efficiency gains.

- The unprecedented fees charged by bankers and kindred promoters, which soon dwarfed all others on Wall Street, suggested that efficiency gains may not have been the sole or even primary object of the game.

In the late '80s, the prices for significant takeover targets, *on average*, were over 14 times earnings before interest and income taxes. That amounted to a return of 7 percent, even while the bidders were then paying on average 10 or 11 percent for capital. Alas, EMT had blinded scholars, and others, too, to what was increasingly clear in the marketplace: the deals were not making sense—to anyone but the middlemen.

With well over $1 trillion of mergers in the 1980s, one should have expected to see a high degree of market efficiency. Instead, the damage has been long lasting. In financial terms, the loss was not just the high default rate, the failed S&Ls and other direct costs, but, as a recent study by the Federal Reserve Bank of New York has shown, the continuing need for refinancings devoted less to real investments than to restoring shattered balance sheets. In human terms, it was a story of workers and middle managers who had long ago invested their careers in the various target companies of the day, but who unlike senior management could not protect themselves.

Neoclassical economists now concede that leveraged-buyout magnates like Robert Campeau, who sought control of many of the nation's department store chains, may have bid too high—hubris produces a sort of winner's curse. But the concession is little more than an effort to control the damage to their prized theory. Campeau, like many another, could buy a major company, say, Allied Stores, investing no more of his own capital than necessary to pay the (not trivial, of course) fees of the bankers and lawyers. The actual purchase price, the only money still at risk, came from a broad cross-section of the banking and financial community here and abroad. It was the hubris of this far-flung institutional market, not just a handful of manic-depressives, that accounted for the excesses. Come to think of it, given their ability to control extraordinary amounts of institutional money with few constraints—First Boston, for example, chafing for fees, virtually threw capital at Campeau—the Campeaus of the day may have been the most rational players in the game.

Remarkably enough, there has not been a single serious effort by such defenders of EMT as Harvard financial economist Michael Jensen, Nobelist Merton Miller, or other traditional finance scholars to retrace their steps, to see how it was that excessive debt increased risk, instead of merely rearranging it as their models had forecast. At best, one observes grudging concessions that mistakes were made, but we learn from our mistakes and are not likely to repeat those *particular* ones again. ("An efficient market, sir, is one in which we succumb to different illusions at different times.")

Count 2: Offering booze to perennial drunks.

EMT now offers up a sacramental blessing to those who would like to believe the Wall Street dogma, "Don't argue with the tape." Ever since Benjamin Graham and David Dodd, and John Maynard Keynes wrote in the 1930s, we have known that the traders and other professionals on Wall Street by and large lack the temperament to invest money on a rational, long-term basis. Graham early on, others of us later on, preached the rewards of ignoring the stock market, except when the manic-depressive

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behavior occasionally offered opportunities to buy or sell on an advantageous basis.

For us preachers, past and present, it is indeed discouraging to see today's scholars dignify, with complex algebraic formulas and computer run-offs, the notion that it is foolish to challenge the conventional valuation of the day's market, that thinking is a waste. Certainly we should not pick stocks.

What, defendant asks—yes, we permit a word for the defendant—has been the damage? First, it lies in the extraordinary growth of index funds. A fund manager, persuaded that stocks are as correctly priced as can be, saves herself the bother and buys the market as a whole, or an index such as the Standard & Poor's 500, as a proxy for the market. Indexers rely heavily on the history that stocks, on average and over time, have performed much better than, say, bonds. But it is a truncated view of history, one that, at best, ignores the proven importance of buying in when market values are at historically sustainable levels. Are the levels today sustainable? Sorry, the question is out of order, one that an EMT-indexer is sworn not to ask.

Indexing confounds the essential logic of a discriminating capitalism, that we move capital and assets to higher valued uses. We all know not to put all our eggs in one basket. But EMT goes far beyond the usual dictates of prudence. Quoting Keynes, who had an enviable investment record with several insurance company and Kings College funds:

> To suppose that safety-first consists in having a small gamble in a large number of different directions . . . as compared with a substantial stake in a company where one's information is adequate, strikes me as a travesty of investment policy.

True, there are many roads to heaven, though I doubt there is any substitute for studying annual reports, as Buffett does in hundreds a year. But it is odd, is it not, that not one EMT theorist has seen fit to study Buffett? Since he began managing money independently 35 years ago, first at the Buffett Partnership and now at Berkshire Hathaway, during strong markets and weak, he has produced average annual rates of return of over 27 percent. For 35 years he has been steadily mining the imperfect prices that EMT says do not exist!

The response to Buffett has been either a deafening silence or a clumsy attempt to avoid the engagement. He's a five-sigma event, it is said, someone whose performance is five standard deviations superior to the norm, so that as a statistical matter he can safely be ignored. The idea seems to be that if we believe pitchers are now so "efficient" that no one can hit .300, we should study large numbers of average hitters rather than a star who has systematically studied the pitchers and the elements of hitting and best of all is willing to impart that knowledge. Or as *The Economist* suggested in August 1992, echoing the academic dogma, in any coin-tossing contest, no matter how many rounds, someone will survive to win, but the identity of the winner is of no consequence. Thus Buffett is explained: 35 lucky flips in a row. Or a few months later, in December, that same always-in-touch journal suggested that Buffett's success is attributable to his having used the "simple trading rule" of buying shares with relatively low ratios of market price to book value. Too bad, in its eagerness, *The Economist* had not bothered to notice that among Buffett's most profitable investments have been companies such as American Express, bought in the 1960s, and Coca-Cola in the 1980s, or that he has written frequently of the irrelevance of tangible book values.

EMT and indexing also stand accused—and this is ultimately the more important aspect of the charge—of being destructive of that basic aspect of capitalism, watching the managers in the store. For an indexer, of course, stocks are homogeneous commodities, as finance teachers say, and there is no need to name the companies in the

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portfolio, much less know or monitor them.

A second remarkable application of EMT goes by the euphonious acronym CAPM (pronounced CAP-M). This capital asset pricing model creates for stocks a measuring stick of risk and then calculates the trade-off between risk and expected returns. Starting from the appealing principle of no free lunch, it states that not only is risk measurable but the expected payoffs, the rewards, are mechanically commensurate. Increase your risk, as CAPM measures it, and your rewards will grow apace.

Just how pervasive CAPM has become can be seen from a recent survey of mutual funds in the *New York Times*, according to which each fund falls into one of five categories of risk. How can they know, I wondered? The answer was in the footnotes to the table. The *Times*, like almost everyone else, has accepted the standard wisdom that prospective risk can be measured. The *Times* assumed the existence of precise arithmetic yardsticks for the outcomes of such palpably uncertain matters as (investments in) the global oil business, discount retailing, pharmaceuticals—and I might add, newspapers—which are subject to political, competitive, and other factors that quite clearly are not measurable.

The *Times* had used a formula derived from CAPM that measures the historic short-term volatility of stock prices. As in all versions of CAPM, the *Times* assumed that prospective *long-term* business risk can be measured by looking at stock market fluctuations over the *short term*—in this case, the monthly prices.

CAPM has insinuated itself into the language and framework of finance so thoroughly that terms such as "risk-adjusted" and the "beta" of a stock are widely used, usually with little comprehension of what a mischievous model underlies them. (The beta of a stock is a measure of its price volatility relative to the market index, which is set at 1.0. A stock with a beta below 1.0, therefore, is said to be less volatile and less risky than the market as a whole.) CAPM confuses the past with the future and the long with the short term. It stubbornly refuses to acknowledge that in the typical business, there is no quantifiable risk but only immeasurable uncertainty. As Keynes explained a long time ago, these are two very different phenomena.

The beta of Capital Cities/ABC is 1.0, the same as that of the market index, but what could we possibly learn from that? The company owns a variety of media properties, including newspapers and the ABC network. Do we really believe that a computer, this remembrance of stock prices past, can tell us that a business with an emerging technology and in a changing regulatory environment will be no more or less risky over the next decade than the market as a whole? Or as Keynes succinctly put it, it is not simply that the calculation would be laborious but rather that very little rational basis may exist for numerical calculation and comparison of any kind.

But wait, EMT and CAPM go still further. They say that the beta, or some similar proxy for risk, measures not just the risk but the expected returns as well. If you want better than average results, buy a bunch of super-risky, high-beta stocks, such as the new issue of the latest trendy restaurant chain or biotech startup. An extra dollop of profits will follow the beta, as the night the day. (And a good night to you.)

Encouraging money managers to substitute betas for careful research and analysis is like offering Jack Daniels to an alcoholic. It is far too tempting. The crime is that it has succeeded so well.

One of the patron saints of CAPM, Eugene Fama, recently announced that the empirical basis for it had dried up. He had not given up the search for a computerized proxy for measuring business risk, but he was now ready to look elsewhere. What followed is truly sad. Scholar on scholar, and of course, *The Economist* too, has said, well, CAPM may not be correct, but we will continue to use it until something better comes along. And so have money

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managers, for whom a bad model seems to be better than none at all. How are we to think about risk, they say, without some computer-based, arithmetic proxy? While a beta may not mean much, it has the one advantage that it is readily calculable.

Count 3: Stealing shareholders' votes.

For roughly 60 years, the one share-one vote requirement of the New York Stock Exchange set the standard, not just for companies listed on the Big Board but for the market generally. It was an accepted part of the financial landscape that if a company invited the public to invest, the public would have, share and share alike, equal voting rights. What changed was the pressure of hostile takeovers in the 1980s, which many corporate managers sought to escape by disenfranchising the public. No raider would pay a premium price for low-voting common stock, or if he did, so what? Seeing that it would lose listings to the over-the-counter market, which had no such equal-voting requirement, the Big Board decided to abandon its long-standing rule and to allow a variety of limited-voting stocks.

Companies are now issuing these dual-class common stocks in greater numbers. The Securities and Exchange Commission tried to intervene in 1988, but the courts bucked the question back to Congress. The issue is currently on the table, requiring governmental action. What to do?

One would have expected free market economists to recoil with horror at the notion of shareholders without voting rights. Without votes, the much-loved market for corporate control would dry up. Much to my surprise, and to the utter delight of the Business Roundtable, scholars proceeded to marshal complex arguments to explain that new shareholders might indeed prefer an arrangement under which they turn over their capital with one hand and agree with the other that management will never, ever be held accountable to shareholders for the use of the money.

It seems odd, but inhabiting a world of (almost) perfect competition, or at least one in which regulation is heavily suspect, many economists believe that prices reflect essentially all potentialities, however remote. As a practical matter, the controversy turns primarily on how to deal with companies that go public for the first time—initial public offerings (IPOs). These economists are saying that if investors don't get voting rights when they buy new issues, they don't pay for them; and if they don't pay for them, they have no cause to complain. More to the point, neither do the rest of us. Voting rights are private property; there is no social interest in preserving for the future the right to recall or dismiss a wayward board of directors or CEO.

Whatever the textbook value of such a laissez-faire policy, in the context of the highly irrational, volatile IPO market, it is wholly out of place. As investors scrambled to buy shares of Boston Chicken when it went public last year, they gave it a market value of $770 million, even though its projected sales (not earnings) for the year were only $44 million. Caring only that the stock was likely to be "hot," how were they conceivably going to price something as remote in value as voting rights, assuming that they thought about them at all?

The Cambridge economist John Eatwell said facetiously: "If the world is not like the model, so much the worse for the world." I have never seen it seriously argued that the IPO market is efficient, even for the basics of price and value. Compared with the ordinary stock market, itself hardly a model of rationality, the IPO market is inferior in almost all respects. Continuity of volume is missing. Security analysts don't look at IPOs, and for that and other reasons, there is a stunning imbalance of information between buyers and sellers. (Buyers rarely see the prospectus that would tell them about their *nonvoting* rights until after they have decided to buy.) Transaction costs are very high, so high that the triple commissions alone should alert us to the probability that the other attributes of a "rational expectations" market are also likely to be absent.

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Over the years, there have been few good studies of IPOs. But the data are very consistent: IPOs are a bad deal; the market does not price the product (new issues) properly. IPOs are bad in absolute terms, they are worse on a time-weighted basis, and they are worse yet when compared with the market as a whole. Being risky, CAPM theory tells us that on average IPOs should outperform the market. Not so; they are a crapshoot. According to an extensive but informal 1985 study by *Forbes* of almost 2,000 IPOs between 1975 and 1985, more than half failed to show any profit from the offering price. On average the group was down 22 percent relative to the Standard & Poor's 500 stock index, and the average annual return for the group was only about 3 percent. A more rigorous 1991 study by Jay R. Ritter, in the *Journal of Finance*, produced similar results.

The defendant EMT has rested its entire case on an abstract notion of rational behavior that implies, in Herbert Simon's words, "a complete, and unattainable, knowledge of the consequences of each choice." (Surely anyone who bought the Class A shares of Resorts International a few years ago could have foreseen that a Donald Trump might someday pay $135 per share for the fully voting, but closely held Class B shares while offering only $15 per share for the Class A.)

The deeper issue here transcends the private rights of shareholders. These Smithian economists assume that shareholders own their voting rights in the same sense that they own their automobiles. Not so. They have voting rights, not to be routinely traded away in private transactions, because of a fear of power without accountability that is reflected in almost every aspect of American life and law. A "smart" economics student might think that in the political arena, votes should be for sale. Or that charitable foundations should be allowed to accumulate wealth and power indefinitely. Or that one generation should be able to forbid their descendants from breaking up their landed or other estates. But as our Anglo-Saxon traditions long ago taught us, power that is frozen for all time will soon be abused. The fact that it was flash-frozen in a market-based IPO is irrelevant.

Count 4: Looting the dividends.

For a company on Main Street USA, owned by, say, ten shareholders, the issue of when to pay dividends, and how much, would seem fairly simple. Putting to one side the question of the investors' need for current income, the central issue would be whether the surplus, freely available earnings of the company would earn more for shareholders if left in the business or if distributed to them. If the reinvestment opportunities were not particularly attractive, shareholders would rightfully expect to see substantial payouts. And even if the performance has been good, some level of dividends would probably be in order. This normal pressure to pay dividends would also be a good check on management.

Sounds obvious, but EMT enthusiasts have managed to distort even this most basic issue of whether to keep the money in the corporation or return it to the owners. Through the reductionist lens of EMT, excessive cash will have no effect on how much is reinvested, and the normal desire of shareholders for an income on their investment is seen as an "irrational prejudice." ("Not only does it seem wrong," one particularly arrogant finance consultant/professor, Stephen A. Ross, wrote, "it is difficult to believe that sensible folk could have held such beliefs.") More important, they have reinforced the obvious preference of corporate managers to do what they are only too willing to do, namely to keep dividends as low as possible.

The problem began about 30 years ago, with a paper by Merton Miller and Franco Modigliani so celebrated that the thesis they propounded now goes simply by the acronym "MM." Their concept was that the value of the company in the market should not be affected by whether the dividend rate is high or low, or even whether dividends are paid at all. Assuming among other

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things that a company's investment program is known, and assuming too that the financial markets are efficient, the value of the company has been fixed, and shareholders should be indifferent to whether the current earnings are reinvested at the assumed rate of return or are paid out. (What is not paid out as dividends will show up as capital gains.) Scholars speak of the MM thesis as if it were a law of physics: EMT will guarantee the "conservation of value" regardless of how the corporate pie is capitalized or distributed.

The MM thesis is a basic tenet of modern financial theory, and literally hundreds of papers and books have been written on the subject. The underlying problem—and the error—are that economists and finance people would like to think only about the impact of dividend policies on stock prices, ignoring their impact on the business itself. M&M and their followers simply assume that, whether the payout is high or low, whether the company is broke or awash in cash, the size of the corporate jet and of management's acquisition spree will remain the same. In the "rational" world of finance, the rich and poor behave alike.

Efficient-rational market theory provided the essential building block for the MM thesis and, of course, encouraged this preoccupation with market pricing. The potential for mischief here is considerable. If dividends are irrelevant, finance scholars say, to incur the tax on dividends is a waste. Better for the company to keep *all the money*, they conclude. CEOs, of course, will agree, many of them being only too ready to expand the present business, buy-and-try a new one, or just feel as cozy as one can only feel with plenty of cash in the drawer. EMT and its offspring, the MM theory, legitimate these self-serving preferences.

At this point, the prosecution rested. Both sides summarized their arguments. The court tried the case without a jury, and the defendant was found guilty on all counts. A summary of the prosecution's recommendations on sentencing follows:

The prosecution asked that the defendant, EMT, be given a life sentence, with no possibility of parole. (The prosecuting attorney abhors capital punishment.) The sentence would be served by denying to all proponents of EMT access to any computer data base of historic stock prices.

The reason for requesting a life sentence was the heavy damage that had been inflicted. Most of it had been inflicted willfully or at least with a reckless disregard for the consequences. With no sign of remorse, the possibility of further harm could not be ignored. As part of a rehabilitation program, the prosecution suggested that EMT and its proponents receive a daily diet of annual reports and other primary financial material.

Conventional finance, the prosecution notes, had failed to recognize, say, the takeover bubble because of its deep disdain for accounting and financial analysis. A respected finance text, Thomas E. Copeland and J. Fred Westin's *Finance Theory and Corporate Policy*, fed to once-innocent business school students, still states as dogma that "investors gain little benefit from [corporate financial statements] because they contain no new information." (Remember, the information has been "impounded"—instantly reflected—in the stock price.) Efficient market theorists failed to heed, therefore, the fact that the ratio of corporate income available for interest charges on junk bonds, which had been a reasonable if modest two-to-one at the beginning of the 1980s, had by the mid-1980s so eroded that the income was 25 percent less than the interest charges. Trusting prices, indifferent to debt, blind to the predator's ball, the den of thieves and the barbarians at the gate, they stubbornly maintained that inflated prices and extravagant levels of debt implied not folly but social gains.

In response to a question from the court about motives, the prosecution said that EMT proponents had been driven by a search for elegance, a word that crops up again and again in the literature. "Ele-

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gance" reflects economists' desire for overarching solutions, algebraically expressed, that will provide the key to a host of issues, and in any season, rather than the messy, context-sensitive responses that most other social sciences produce. Indeed, economists tend to reject the label "social science," although that is obviously what it is.

The pattern, the prosecution continued, is not new. Friedrich von Hayek—not Keynes, Hayek!—had something similar in mind in his Nobel lecture of 1974, when he criticized economists for straining to mimic the quantitative precision of the physical sciences. In so doing, he observed, they were ignoring the fact that theirs is a complex social study in which quantitative data would be hard to come by. He might as well have been referring to CAPM and the like when he chided economists for ignoring what is important in favor of that which happens to be accessible to measurement.

The defendant was duly sentenced. When last observed, the authorities were feeding the prisoner a diet that included the writings of Buffett, Philip Fischer, Graham, and Keynes, enriched with corporate annual reports. Color had returned to its cheeks, it had gained weight and was heard repeating as a mantra, "you are neither right nor wrong because the market agrees with you."

Dismayed by what they observed, the prisoner's relatives, CAPM and others, visited but once. They did, however, maintain contact with one another, meeting in a ritualized setting. Computers were booted up, votive candles were lit, and the following prayer was said:

EMT
We believe in thee.
We are as one,
Thy will be done.❖



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What's Trust Got to Do with It?

Richard C. Leone

Despite its strains, the marriage of democracy to capitalism is a durable one. These days, however, we display little trust in either our economic prospect or our system of governance. Yet neither markets nor elections will produce happy results if distrust and self-interest overwhelm common rules and compromise other necessary values. Trust, after all, is not a product of popular elections and booming markets; it is a prerequisite for both.

This nation is constructed on overlapping communities, often ill at ease with each other. Yet somehow in the past, when necessary, we have made common cause for the necessary sacrifices that create an enlarged future. We found consensus with the help of political, business, labor, cultural, religious, and media leaders. But today, is there a national public figure who is widely trusted?

During the past 20 years, Americans, not for the first time, have moved beyond skepticism to disdain of politics and government. One recent survey indicates that 80 percent of Americans believe that government favors the rich and powerful, up from 29 percent in 1964; 65 percent believe that "quite a few" government officials are corrupt, up from 45 percent in the wake of Watergate. *Time* magazine finds that the percentage of people who believe that the government generally will try to do the right thing has declined from over 60 percent in 1964 to about 10 percent today.

Americans, of course, have not fallen into some collective hysteria. Recent history has provided them with good reasons to doubt government. The Kennedy assassination and its endless conspiratorial aftermath set the stage, followed by Vietnam, then Watergate, Abscam, Iran-contra, the fall of Jim Wright, the "House bank," Nannygate, and Whitewater.

Why should Americans trust leaders enough to believe that it is worth giving up a reward today in order to have more tomorrow? The real answer is: they have no choice. Government is the way we make decisions as a society, as well as the necessary instrument for public investments in our future—physical ones like bridges and airports, as well as research, training, and education.

A revival of confidence in government will take time; the sources of public anger are deeply rooted, and not just in political scandal. They include the ongoing economic crunch facing America's families, the increasing infusion of personal and social issues into political discourse, the negative nature of recent electoral campaigns and the increasingly harsh and self-reinforcing portrayal of politics and politicians in campaigns, in the press, and in the popular culture. Yet these all too real sources of discon-

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tent do not necessarily preclude trust. One need only think of Franklin Roosevelt to realize that difficult periods can create immense opportunities to satisfy the public's desire to be led back into the light. (But imagine the portrayal of Eleanor and Franklin in a modern campaign.)

Economic Discontents. If there is a cultural constant for Americans, it is the promise of economic betterment. Especially since FDR, we have expected the national government to take responsibility for improving economic performance. Politicians take the credit for good times—and the blame for the bad ones.

But Americans are schizophrenic about the role of government in the economy. We simultaneously revere free enterprise and hold public institutions and leaders accountable for how the economy is performing. The gods of the market may be uninterested in the fate of individual companies, localities, or people, but we expect those we elect to save us from the market's ruthlessness. The same governments blamed for distorting the purity of market forces are held accountable for failing to revive growth.

Social Discontents. For a generation, social conflict has created backlash against government-as-social-engineer. Culture has also intruded into politics in a second sense, as the personal has become political. At the 1992 Republican convention, Pat Buchanan declared that America is in the midst of "a cultural war, as critical to the kind of nation we shall be as the Cold War itself." In any political campaign, a candidate's position on abortion, family values, multiculturalism, gay rights, gays in the military, censorship, sex education, free condoms and/or needles, as well as the cluster of racially loaded questions that are both economic and cultural, is likely to generate as much attention as his or her views on national defense, taxes, or foreign policy. Likewise the candidate's own hitherto private life.

Past generations, of course, engaged in bitterly divisive debates over religion, prohibition, and most notably the morality of slavery. What creates a special tension today is the degree to which personal (especially sexual) questions have moved beyond whispered conversations and anonymous rumor to take center stage as a routine part of public discourse. The public is at once made uncomfortable and titillated by this turn of events. As talk-show fare crowds out loftier public discourse, the public pays salacious attention, but becomes cumulatively more cynical about both the politicians whose sex lives are probed and about the media doing the probing.

Media-Mongering. If even mainstream media coverage of politics, increasingly, has degenerated into the gossip, scandal, and trivia of "tabloid TV," one explanation is obvious: this stuff attracts audiences and sponsors. In this sense, the coverage we are getting is what the free market supports, which is not always identical with what supports democracy.

In the past, the major networks, the national news organizations, the big publishers, and the weekly news magazines—the "blue-chip" media—left gossip to the tabloids. In the last decade and a half, the media, like most sectors of American business, have undergone sweeping reorganizations, with takeovers, buy-outs, and sell-offs. Market pressures and technological innovations have driven even mainstream media to softer standards.

In the 1990s, the issues raised by tabloid journalism have muscled their way onto the political agenda with depressing insistence. Our popular culture relentlessly portrays American political life as dominated by corruption, venality, sexual escapades, deals, personal peccadilloes—everything but the substantive work of governing.

This kind of coverage may attract viewers, but it also alienates voters. During the 1992 presidential election, viewers turned in large numbers to television programs in which the candidates spoke directly to them. At some level, the voters perhaps understood that public character is

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really about leading tough fights on issues, rather than so-called character questions.

Regulation of the press is abhorrent in a free society. But an unexamined press is scarcely worth having. We have been far too timid in asking journalists to live by the precepts of their own profession. We need their help to reclaim a public culture that makes room, amid all the gossip, for our leaders to articulate a vision of America's possibilities (assuming they have one)—to make it possible for them to lead.

What can be done to alter a press that, in the nature of the case, should be left largely to its own devices and the discipline of the marketplace? A Twentieth Century Fund Task Force on television coverage of the 1992 election proposed a few modest steps:

- Clearly label electronic news releases throughout their broadcast.
- Institutionalize self-criticism and peer group pressure, through expanded coverage of the media by regular print and on-air reviewers and self-criticism by internal ombudsmen.
- Provide more time for the electronic equivalent of letters to the editor.
- Offer more journalistic awards that, like the new Pulitzer Prize for "explanatory journalism," encourage reporting that goes beyond exposés toward more complex truths about major issues.

1-800 Populism

A periodic loss of faith in politics is hardly a new phenomenon: a hundred years ago William Jennings Bryan and the Populist movement fed off the discontent caused by immigration, industrialization, and the decline of the family farm. It would be surprising if the current wrenching changes in manufacturing, families, and culture had *not* spawned a similar reaction, including a revival of scapegoating and populism.

One striking difference between the current version of populism and that of Bryan and his followers is the acceptance of a billionaire, Ross Perot, as its leader. It's hard to imagine the unorganized workers, displaced farmers, and old time religion fundamentalists of a century ago rallying to a "movement" led by Cornelius Vanderbilt, Andrew Carnegie, or John D. Rockefeller. But, of course, none of those worthies had an opportunity to appear on *Larry King Live*.

Another key difference, as the historian Richard Hofstadter tells us, is that the earlier "agitation of populists . . . brought back to American public life a capacity for effective political indignation." The populism of a century ago provoked a thoughtful bipartisan movement among more affluent and better educated Americans. Like the followers of Bryan, they demanded more, not less, government action, but they also had in mind constructive ideas about how to make government more effective. Their program was a progressive agenda that went well beyond breaking up the trusts and regulating the banking system. It elevated and ultimately trumped populism's arguments by offering reforms built upon analysis and professionalism, including revision of the civil service and promotion of the city manager system. These responses were scarcely "concessions," nor did they involve a tactical slide to the right to blunt anti-government criticism. One wonders how many of today's politicians would simply duck if confronted with a similarly imaginative response to the challenge of Perot and Rush Limbaugh.

The new populism, like the old, involves attempts to limit the power of government and elected officials and to enhance direct democracy at the expense of the legislative process. As before, today's version is more attuned to nostalgia for a half-remembered past contentment than to visions of a utopian future. But rather than enriching democracy, the modern populist agenda oversimplifies and hobbles the ability of leaders to build support for complex and demanding answers to difficult and serious

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questions. Populism's surge is evident in the number of ballot initiatives and referenda in the 26 states which allow some form of this type of direct democracy. In California, 142 ballot measures were put before the voters in the 1970s and 139 in the 1980s; these were the highest levels since the 1930s. The use of the recall device has grown as well, winning about 70 percent of the vote last fall in New Jersey. Last year, 20 city council members across California were defeated in recall elections. A related phenomenon is the growing support for term limits. In the 1992 elections, voters in 14 states passed measures to limit the terms of their state and federal legislators.

Save Us from Ourselves

The core paradox of modern populism is that its favorite remedies actually limit public choices. A prominent Perot-populist solution to our economic problems, the balanced budget amendment, would leave government unable to respond to economic downturns. At the next business-cycle recession, the citizenry would doubtless blame the government.

Instead of a simple balanced budget amendment, we need a capital budget. Families, companies, and local governments all borrow for the long term. We all understand that paying for capital outlays over time makes sense, for these projects increase economic growth, creating a bigger pie to slice up among all of us. But the U.S. government has no special budgetary category for capital expenditures. If federal budgets were honestly divided into current and capital categories, then much of the currently mismeasured deficit problem would disappear.

The balanced budget amendment is part of a larger illusion that we can achieve good government only by having less government or by putting government on automatic pilot. Or maybe, deep down, it is ourselves we don't trust. The support for term limits, after all, is just another way of saying we don't trust ourselves to vote out officials we don't want. In this sense these amendments seek to protect us from our *own* unwillingness to make choices—such as electing people with the guts to tell us no when we ask for services without accepting the taxes to pay for them.

Nobody Said It Would Be Easy

The 1993 gubernatorial race in New Jersey may have involved (depending on *when* you believe Ed Rollins) a particularly cynical political technique that scarcely would help rebuild confidence in the fairness of the electoral process. But, moving beyond the possibility of a tainted campaign, there is a tendency to read the outcome as simply implying that raising taxes to fund urban programs and balance budgets is certain political suicide. Governor Jim Florio's taxes did result in fury among voters—his positive rating dropped to 19 percent—not the least because they did not feel he had leveled with them during his first campaign. It was hard to find an automobile in the state without an anti-Florio sticker. But the hard work of explaining the painful choices almost paid off. Florio came within a hair of pulling off a stunning victory, and his successful recovery started almost from the day he started to explain the truth about the state's circumstances to voters.

What politicians should learn from the race in New Jersey is that truth-telling and even taxing to rebuild education and infrastructure can make real sense to people; certainly they are preferable to more fudging of the facts about what is needed to put us back on track.

To take a national example, the president's successful fight for NAFTA represents a clear request for and a modest restoration of trust from the people. Trade policy, after all, is based upon a set of sophisticated notions about comparative advantage and international economic growth, concepts that are difficult to understand. It often brings out the worst in policy debates, because the benefits are abstract and widely scattered, while the costs are keenly apparent to those who face the cutting edge of new competition.

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The sort of economic integration one sees in Europe, for example, is made politically possible and personally tolerable by the existence of strong social support and worker training on the one hand, and specific economic development commitments to weaker members of the EC on the other. The lesson of the European experience is that international economic integration is a lot easier if a nation is fully committed to social services, relocation assistance, and worker retraining. Free trade arguments usually wind up as simple choices between free markets and government intervention. But, in fact, wider trade *requires* a new set of government activities.

The Gore-Perot debate on NAFTA was an exemplary form of public education. As politically risky as this event was, it demonstrated that going directly to the people to make your case remains a key route to restoring trust. Bill Clinton will be trusted even more on trade when he acknowledges and addresses the very real fears people have about its consequences.

Reclaiming Trust

To reclaim trust we must overcome the fact that the citizens of this modern secular state concede a very limited status to figures of authority in government and business. It is celebrities who command widespread allegiance and influence. (They can sell sneakers can't they?) But post-World War II America is not a place for durable eminence. You can be famous for 15 minutes, but not beloved for the whole quarter-hour. We, in a sense, have achieved Jacksonian (Michael and Janet along with Andrew) democracy with a vengeance. The measures of status, celebrity, and influence have broken through the boundaries of class and perhaps even respectability to run together, producing an elite that is merely newsworthy.

All this makes perfect sense, if decentralized power, fast entertainment, and the pursuit of wealth exhaust the goals of our society. But of course there is more to American democracy than celebrity and private pursuit of enrichment.

American society has grown up and prospered along two seismic fault lines: in economics, between wide-open markets and government regulation and, in politics, between sharp partisanship and consensus. Occasionally there have been massive upheavals like the Great Depression and the more recent but less politically articulated turmoil from deregulation and international competition. There seems to be no such thing as a permanent equilibrium between the perceived interests of business and of the public.

This administration will make more sense to voters when its convictions about public responsibilities come into clearer focus. One thing Reagan did well was to justify his tactics in terms of his goals, not the other way round. Now that the voters have chosen a president with a more balanced view of the role for the public and private realms, Clinton must build upon the beginning he made in 1992 to reeducate the public about the fundamental importance of the public enterprise.

The Clinton administration was right in early 1993 to propose a package of expenditures for public and social investment. Such investments make especially good policy when the economy is slack and there is idle capacity. And they reinforce the social contract and the reputation of government. The administration's mistake, however, was to let opponents characterize the initiative as merely a "stimulus package." A fight on those grounds, in the current environment of cynicism, inevitably turned into an uphill struggle against the belief that all such government programs turn into more pork barrel spending. The fight, of course, turned out to be one-sided since Clinton's adversaries were able to invoke the conventional wisdom that Washington is run by the venal and, worse, that our system of self-government is incapable of rising above such selfishness.

Too many of the excuses for Washington's inaction or obfuscation are just other ways of saying that trust in our

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leaders and confidence in ourselves is no longer attainable. And that conclusion must be nonsense, for it assumes that we are content with the current state of affairs and incapable of improving them.

We are today in the early and delicate stages of a reaction against the decline of trust. There is a popular surge in favor of new public actions, and a yearning for restoration of the compact between government and the governed. It is, for the present, a vague and inchoate mixture of electronic democracy, New Age openness, and even misdirected longing for a mythical past. But it is undeniably powerful, and it suggests new opportunity.

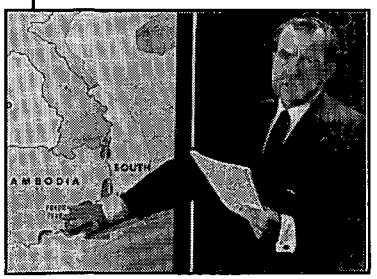
To lead in this environment requires an extraordinary degree of "truth telling." Leaders must gamble that there can be a consensus to reward such behavior. It won't work at once; it probably will chew up many political and business leaders along the way; but it is the only real hope we have of facing and overcoming our stagnation and reviving civil society.

We do live in an age of disappointment, resurgent populism, and facile answers. To restart economic and civic development demands reestablishing trust. There is no substitute for a president who will lead this revival. He must lead because there is no safe political finesse—no matter how cunning the spin—that offers a way to duck these issues. He can demonstrate to politicians and the press alike that it pays to treat Americans like grown-ups, still capable of understanding and shaping their destiny.❖

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Norma Becker (left) before the First International Days of Protest march in New York, 1965. Courtesy Norma Becker.



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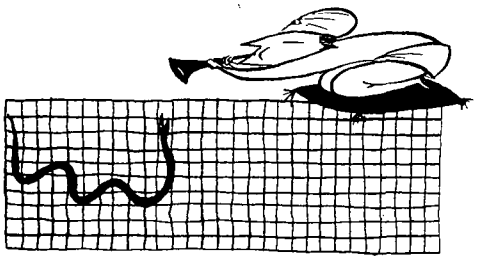
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Making the Poor Count

Deborah A. Stone

The poverty line is a stock figure of American statistical and political culture. Most of us are at least dimly aware that it is an official level of income used to separate the poor from the non-poor, that the government somehow sets it, that it changes from time to time, and that it is the topic of periodic political fights. Even those who know its arcane details, however, usually forget that our official



measure of poverty was once crafted by a real person with a passion and a pencil.

The person was Mollie Orshansky. In 1963, she published an article about poverty that set the U.S. government on a new path. "Children of the Poor" ran in the *Social Security Bulletin*, an otherwise rather dry publication of the Social Security Administration's Division of Research and Statistics. By the time the decade was out, Lyndon Johnson had included her poverty estimates in his 1964 Economic Report of the President, the Office of Economic Opportunity had adopted her methods for determining eligibility to its programs, and the Bureau of the Budget had mandated that the entire federal statistical establishment use her definitions and methods in reporting poverty.

The story of Mollie Orshansky and poverty measurement is a case study in what makes political arithmetic persuasive. "I wanted to show what it was like not to have *enough* money," she told me in an interview last summer. "It's not just that the poor had less money—they didn't have enough. I knew you couldn't spend for one necessity without taking away from another."

Orshansky knew whereof she spoke. The child of Russian Jewish immigrants, she grew up in Brooklyn in the 1920s. Sometimes her father couldn't support the family of six daughters, even when he had work. Sometimes she went with her mother to apply for relief. ("If they gave you pork, you took it even though you couldn't eat it, because you didn't want to seem ungrateful.") She learned easily to forgive the other women in line from her neighborhood who lowered their eyes and pretended not to see her and her mother.

The core of Orshansky's idea was to use the cost of a nutritionally adequate diet as the basis for a cost-of-living estimate and to calculate a cost of living for families of different sizes and composition. Because she had come to Social Security from the Bureau of Home Economics and Human Nutrition in the Department of Agriculture, Orshansky was eminently familiar with the department's food plans. These plans set forth quantities of various food groups—meat, bread, potatoes, fats, fruits and vegetables, and so forth—necessary to sustain adults and children, and using current prices, found the cost of food necessary to feed families on these rations. The department calculated several levels of food plans, which were more or less generous but whose names were as opaque as canned-olive sizes: instead of jumbo, colossal, and extra-large, the Department of Agriculture called its food plans liberal, moderate, low-cost, and economy (in descending order),

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the latter renamed thrifty in 1975.

Orshansky came up with 62 family types based on the number and ages of children, and for each she created a farm and nonfarm version, making 124 categories. For each of these, she calculated a food budget based on the low-cost plan and one based on the economy plan, giving 248 categories in all. Here's where the pencil came in.

Food is not the only thing a family needs to live, but Orshansky chose it as the basis for her measure because there were relatively good studies of diets and their cost. She still needed a way to relate the cost of food to the cost of a family's total needs. A 1955 Department of Agriculture survey had shown that the average family spent one-third of its income on food. Orshansky assumed that families who must spend more than a third of their income on food were probably giving up other necessities—or food. So she made the elegant simplification of multiplying the cost of a family's necessary food basket by three, to arrive at an imputed total income that would put that family on the threshold of poverty.

For a non-farm family of two adults and two children, the low-cost food plan (multiplied by three) yielded an annual income of $3,995, enough to keep the family above poverty, and the economy plan yielded a figure of $3,165. Though Orshansky was dogged in creating 124 family types and income requirements, the media latched on to the archetypal family of four (minus cat or dog) as the magic number that would be called "the poverty line." In fact, the poverty line is the entire set of threshold incomes for different types of families.

Now that Orshansky had a way to measure poverty—to decide *whether* to count each household as poor—she needed a way to find out *how many* households were poor. For that, she needed to apply her definition to the whole population. With a $2,500 budget from the Social Security Administration, she went to the Census Bureau to get data on family and household income. The bureau had regularly calculated income for families of different sizes, but had never looked at income in relation to family composition: the number of children and adults and the ages of children, and the sex of the head of household. Orshansky used her $2,500 to buy these calculations, and when all was said and done, she concluded that somewhere between 17 million and 23 million children were poor.

"Children of the Poor" did for Washington bureaucrats what Michael Harrington's *The Other America* did for the broad reading public. Harrington had a journalist's flair for revealing the poverty Americans had ignored and for evoking empathy and outrage. Orshansky had the economist's capacity to give quasi-scientific backing to political will.

Preprints of "Children of the Poor" were circulated widely before publication and reached Sargent Shriver and others in the Office of Economic Opportunity. Legal advocates for the poor found inspiration in her measures as well. In 1964, the Justice Department called on her to help fight the poll tax; she fashioned the argument that even a $2 poll tax could deprive a poor family of a day's worth of food. In 1965, the OEO adopted her measures; in 1969, after a slight revision in the method of setting poverty thresholds, the Bureau of the Budget directed all federal agencies to use the Orshansky measures. In six years, her methods had become the indispensable tools of the poverty agencies and the standardized procedures of the statistical agencies.

To be sure, Mollie Orshansky was not the first to relate poverty measurement to the cost of food. The English town of Speenhamland in 1795 instituted a relief system that made up the difference between a worker's wage and the cost of bread sufficient to feed him and his family. In the early 1900s, several American private charities and public agencies had calculated family budgets and used them to determine relief amounts. But in the early 1960s, everyone else was counting poverty by seeking a single income level

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for families of every size and description. The 1964 Report of the Council of Economic Advisers, for example, used a figure of $3,000 as a threshold for *all* families.

Asked why her work was so influential, Orshansky usually cites three reasons. First, there was an accident of timing. "It appeared when needed," she wrote in 1988. She credits Lyndon Johnson for being ready to do something about poverty. Second, by linking poverty measures to dietary requirements and household consumption surveys, she provided a seemingly scientific rationale for poverty thresholds. And last, her estimate of $3,195 for a family of four gained plausibility by being very close to the Council of Economic Advisers' "one-size-fits-all" figure of $3,000.

There are no doubt additional reasons why her work was so influential. It was innovative, argumentative, and aggressively political. It was arithmetic from the heart. It was meant to tug at our consciences, and it gained its leverage from having its feet planted in poor people's lives.

Orshansky insisted that family size and composition made a difference in people's living standard. She refused to think in abstract aggregates of households or families. She knew she "needed to prove" that it cost more to feed more kids, and that it cost more to feed teenagers than infants. "This was the female side of research," she said.

Others looked at data showing that large families spent less per person on food than smaller families and called it economies of scale. Orshansky looked at what food these large families actually bought and saw that it was often nutritionally inadequate. "It appears that what passes for 'economy of scale' in the large family may in part reflect a lowering of dietary standards enforced by insufficient funds," she noted in "Counting the Poor."

Many economists said that if a family has insufficient funds, the housewife will just stretch the food dollar. But "economizing inside the family doesn't go even-Steven," Orshansky insisted. She explained this comment to me by spinning a hypothetical tale that is only thinly disguised autobiography: Father brings a couple of unexpected guests home to dinner, confident that Mother will just stretch the food, as she is so good at doing. Mother pulls her daughters aside and tells them, "When the meat comes around, you take one small piece and pass the dish on. Same with the potatoes." And when the meat dish comes to Mother, she takes nothing.

Orshansky refused to act as if a family is a family is a family. She looked at families by sex of the head of household, because she thought it would make a difference. It did. Mother-child families had more children on average than what she called husband-wife families. Mother-child families of every size also had dramatically lower incomes than husband-wife families

READING MOLLIE ORSHANSKY

"Children of the Poor," *Social Security Bulletin*, July 7, 1963

"Counting the Poor: Another Look at the Poverty Profile," *Social Security Bulletin*, January 1965

"Who's Who Among the Poor: A Demographic View of Poverty," *Social Security Bulletin*, July 1965

"Recounting the Poor," *Social Security Bulletin*, April 1966

"How Poverty Is Measured," *Monthly Labor Review*, 1969

"Measuring Poverty: A Debate," *Public Welfare*, Spring 1978

Gordon Fisher, "The Development and History of the Poverty Thresholds," *Social Security Bulletin*, Winter 1992

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with the same number of children. For example, mother-child families with two children had a median income of $2,390 while husband-wife families with two children had a median income of $6,615.

One of Orshansky's "Aha!" moments came when she found that in 1961, the median income for a non-farm family headed by a woman was about $2,340, and 40 percent of these families had less than $2,000 a year to live on. She remembers rushing into her boss's office, interrupting a meeting to proclaim her horror: "These women have to live a whole year on no more than I paid for one statistical table!" One of the women at the meeting chided her not to get so excited: "If you didn't use the money for your tables, Mollie, those women still wouldn't get any of it."

Orshansky understood that having a *plausible* measure was more important than pinpoint accuracy. She dedicated herself to making poverty measures reflect the reality of poor people's lives, but for her, the purpose of research was action, not "producing an intellectual treatise." "I don't think we should sit around debating whether we should do something for 32 million children or 26 million children when we haven't even done anything for 10 million."

Orshansky made her measure something people could feel. She related it to food and peppered her studies with images of what it's like to be poor. Washington was talking in terms of a minimum annual income for a family of four—Johnson's 1964 Economic Report of the President cited her $3,165 figure. Orshansky broke down that annual income into the 23 cents per meal per person it allowed, and even some of the food budget-makers in Agriculture were stunned. No one could fix a meal for that, they protested.

Orshansky's poverty thresholds were often criticized by the Left for being too stringent, and especially for using the Department of Agriculture's economy plan instead of its low-cost plan. Orshansky, though, was more cognizant than anybody of just how stringent the economy plan was. She publicized the Agriculture Department's own caveat that the economy plan was sufficient only in emergencies and on a temporary basis. She didn't remain abstract in her criticism, either. In "Children of the Poor," she invited middle-class readers to ponder the assumptions of the economy plan budgets: "They assume the housewife will prepare all the family's meals at home. There is no additional allowance for snacks or the higher cost of meals away from home, or meals served to guests. Nor is there extra allowance for the ice-cream vendor or the soda pop so often a part of our children's daily diet."

In "Counting the Poor," Orshansky put a day's food allowance into the figurative housewife's pocket and asked readers to share her plight: "The poverty line would allow a housewife with a husband and two kids about 70 cents a day per person for food. For a meal all four of them ate together, she could spend only 95 cents, and to stay within her budget, she must allow no more a day than a pound of meat, poultry, or fish altogether, barely enough for one small serving for each family member at one of the three meals."

I asked Orshansky if she had always wanted to do something for children or against poverty. But my question came from a different generation and a different economic experience. "I never thought of what I wanted to be. . . . You didn't plan to be anything—you planned to get a job."

She was the only one of the "girls in the neighborhood" to go to high school because when she graduated from eighth grade at 14, she was not old enough to work. Since she had younger sisters at home to support, she would never have gone to college but for two scholarships from Hunter College. She graduated with a major in mathematics and statistics and a minor in physics. Her first position was as a statistical clerk in the New York Department of Health. After a year, she was recruited to the Children's Bureau in

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Washington, D.C. Then she worked in the Department of Agriculture, and eventually came to the Social Security Administration in 1958. In all these jobs, she did what she was assigned. She was not a crusader.

Perhaps she was as much fired up by the times as she herself fired up the poverty warriors around her. She came to work on children in poverty serendipitously, after being dropped from another project that she found pretty boring anyway. Looking at children was her idea. Her first excursions into that $2,500 worth of data resonated deeply. "I don't need a good imagination when I write about the poor," she told me. "I have a good memory."

Talking about the difficulties of lifting kids out of poverty, she reflected: "You're asking someone to go alone, to break away in a sense, from the family, and to move to a group where they're not necessarily accepted. If you're 13 or 14 or 15 . . . ," her voice trails off for a moment. "It's difficult to alienate children from what they know. The things parents want for their children—the things they do out of love—make a gap."

Perhaps because she knows what it's like to have lived in that gap, she looks back today and says, "I wasn't doing a poverty line—I was doing what was necessary."

Orshansky's necessity is still the foundation of today's poverty measurement, though her measures have been much distorted from what she originally intended. Orshansky shares the main criticisms that have been leveled. According to Gordon Fisher of the Social Security Administration, people in the SSA, the Census Bureau, the Council of Economic Advisers, and the OEO all knew by 1967 that food had gone from one-third to one-fourth of the typical family's expenditures. Orshansky proposed using a multiplier of four, but by then, the OEO was already using the old thresholds based on the one-third figure, and it opposed any change. Similarly, Orshansky would not have chosen the economy plan as the basis for an official measure, but the OEO did, and OEO's poverty definition set the terms for the future.

Food now constitutes only one-fifth of non-poor families' budgets, but no agencies have been willing to use a multiplier of five. To do so would send the official poverty rate way up and create political pressure for dramatic increases in poverty spending. In *The Forgotten Americans*, John Schwartz and Tom Volgy show that if the official poverty measure were adjusted to stick more closely to Orshansky's original principles, the poverty rate for 1989 would have been 25.6 percent instead of 12.8 percent.

The poverty measure has not kept pace with rising real income standards, even though, since 1969, the thresholds have been adjusted by the Consumer Price Index. As Schwartz and Volgy show, any realistic measure of the minimum income necessary to cover basic necessities is now about 50 percent higher than the official poverty thresholds. In the opening paragraphs of "Children of the Poor," Orshansky foresaw the problem: "As the general level of living moves upward and expands beyond necessities, the standards of what constitutes an irreducible minimum also change."

The poverty line illustrates how a measure can take on a life of its own. Agencies become invested in protecting it from change. The current poverty lines based on Orshansky's measures are certainly too low and therefore fail to acknowledge millions of people who lack a decent standard of living. Yet despite numerous attempts during the Reagan and Bush years to manipulate the measures so as to make poverty seem to disappear, Orshansky's concepts protected a large core of the poor from statistical and political invisibility. Her thresholds were there not only when they were needed, but also when they were distinctly unwanted.

For all its independence, the poverty line also reflects the life of its creator. Perhaps every social measurement should be designed by someone for whom the job is necessary.❖

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Pork and the Public Interest

Kenneth P. Ruscio

Communities sharing "languages of good and evil" are more likely to be bound together by a stronger glue than those based merely on shared self-interest.

Francis Fukuyama, *The End of History and the Last Man*

Pork barrel politics has acquired odd, new bedfellows. In a recent issue of the *Public Interest*, John W. Ellwood and Eric M. Patashnik extol—of all things—the congressional trough. Their gambit is to persuade the reader that individual members of Congress are hopelessly inclined to vote for narrow interests rather than a broader public interest. The benefits of the pork barrel are concentrated, they argue, while the benefits of fiscal prudence are diffuse. "The result has been the creation of a political climate in which elected officials believe that the only way they can bring the nation back to fiscal health is to injure their own electoral chances."

This being the case, they propose: let's be realistic. Why not let congressmen have modest slices of pork for their districts—contracts, grants, public works—for which they can claim credit? In exchange for this maintenance dose of pork, perhaps Congress can be manipulated into pursuing a broader public interest once in a while.

The underlying premise of this cynical argument will be familiar to readers as a variant of public choice economics, a school of thought that explains political outcomes as nothing more than the products of countless actions by self-interested individuals and politicians as nothing but selfish "rent seekers." Ellwood and Patashnik take this concept to a new level of contempt for the possibility of public purpose.

Revealingly, their example of the sort of public-mindedness that Congress would not pursue, absent outright bribes, is deficit reduction. Yet, curiously enough, six months after their article, "In Praise of Pork," was published in the Winter 1993 *Public Interest*, Congress in the 1993 budget deal agreed to reduced the deficit by $496 billion over four years. As this article goes to press, Congress is reining in a number of cherished programs as part of the FY '95 budget process, and a sizable coalition is pressing President Clinton for even deeper cuts. Pork remains a temptation, but could it be that Congress, defying public choice theory, has actually been motivated by a larger purpose? Could it be that the *Public Interest* is reading its own cynicism into the political process?

Public choice theory offers a disheartening view of politics and public life. Of citizens, it asks nothing more than the aggressive assertion of one's own interests. Of public officials, it asks nothing more than calculating the net electoral benefits of a particular course of action. Its subtext is that the quest for public good is illusory and that the preferred course is to minimize a public realm that will only be corrupted by self-interests. In the academy, public choice has become the newest orthodoxy, leading its adherents to view politics as merely the pursuit of private advantage. And it has been all too influential in recent debates.

Schools and Markets

Relying heavily on this view of politics, a common theme of recent school reform

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proposals is that the private interests of teachers and educational bureaucrats drive the ways schools conduct their business and lead to dismal outcomes. Education is seen as a struggle among parents and their children concerned about their competitive advantage, teachers and administrators concerned about job security and resources, and businesses concerned about a pool of workers. The most prevalent diagnosis is that the teachers and administrators have captured the system, a victory made possible only because politics places authority in their hands. The response is a call to arms. The people must take charge by waging war against the entrenched interests that control their schools.

The most sophisticated theoretical argument in this vein has been John Chubb and Terry Moe's *Politics, Markets, and America's Schools*, in which they propose an educational system based on parental choice. They assert that the system must be redesigned so that each participant's self-interested choices (there can be no other kind) yield a collective outcome of high-quality education. The consumers of education will determine its shape in the same way that demands in the economic marketplace ultimately determine the kinds of products available.

Chubb and Moe base their analysis on a revealing premise. "Schools have no immutable or transcendent purpose. What they are supposed to be doing depends on who controls them and what those controllers want them to do." The political struggles to improve education are therefore simply battles between competing power seekers, and the outcome yields not a public interest but a capture of a public enterprise by a set of private interests. Their solution requires that we reject as unworkable or counterproductive the imposition of higher order values, because the system will only impose the values of those who control it. A corollary is that the role of government is minimal or nonexistent. The logic is relentless: if there is no public ("transcendent") purpose for education, then politics becomes an inefficient annoyance. In the Chubb and Moe plan, the role of public authority is to create a system without public authority.

Pork Barrel Science

If Ellwood and Patashnik hope that a public interest can be achieved by sanctioning the unfettered pursuit of private interest, the case of "pork barrel science" might give them pause. It also shows how a system built solely on maximization of private interest is not an inevitable development.

Throughout the late 1950s and 1960s, federal support for research grew rapidly and in ways that produced clear patterns. The outcome of a congressional fight early in the history of the National Science Foundation assured that the largesse would be distributed primarily on the basis of the quality of science. On the losing side was West Virginia Senator Harvey Kilgore, who proposed allocating research funds on the basis of geography, local economic considerations, and direct political control by Congress. Vannevar Bush, author of *Science: The Endless Frontier*, successfully countered with a plan to have panels of scientists review carefully prepared proposals from researchers in the field. A peer review process, not politicians, would award grants to those best able to perform the work.

Predictably, the institutions that found early success became better able to attract talent, thus securing an even more favorable position in future competitions. By 1989, 40 percent of the federal money was concentrated in 20 institutions, and 46 percent was concentrated in Massachusetts, Texas, Maryland, New York, and California. To the victors this was simply a case of quality and success being rewarded. To the losers it was the old-boy network ensuring that while the rich got richer, the poor got poorer and less able to compete.

By the mid-1980s, a backlash was developing. Rather than tackle the peer review process, which they believed was rigged against them, individual univer-

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sities took their cases directly to their representatives in Congress. Pork barrel science —the new game of universities lobbying for earmarked legislative disbursements— was becoming commonplace. In the same way that bridges, post offices, and water projects are awarded to congressional districts during the appropriations process, so would university research grants and facilities for research be awarded to colleges and universities. In the 1993 budget, $763 million was distributed through the pork barrel system to schools as renowned as Berkeley and Carnegie Mellon, as well as to lesser known colleges such as Dowling College ($4.5 million), St. Norbert College ($3.9 million), and Mount Aloysius College ($2 million).

Several years ago, before the emergence of pork barrel science, Joseph Ben-David, a noted sociologist of science, warned, "If science is perceived as partial to some social interests and scientists are seen in an invidious light, then people may start doubting the moral value of seeking scientific truth for its own sake and applying it for the purpose of changing the world. This may spell the end of scientific culture."

It does seem clear that the reasons for funding science are now more complex and that the scientific culture has met a political culture head-on. Support for research reveals a system of legislators acting in their self-interest, which is defined as the need to bestow private benefits on constituents who are acting just as much in their self-interest. "It's the classic American way," according to the president of the Association of Jesuit Colleges and Universities. "That is why these guys and ladies are elected."

Peer review science now co-exists with pork barrel science. Much of the nation's research and development spending is still allocated on the basis of relatively objective review, and it remains to be seen which set of values will prevail.

Proposals such as Ellwood and Patashnik's legitimate the view that the search for a public interest is hopeless. They cause us to forget that at one time we had higher hopes for our political system, a loftier understanding of the duties of citizenship, and a belief that discovering a common interest was the purpose of politics.

Public choice theorists move too easily from explanations about what seems to motivate our elected and appointed officials to judgments about what should motivate them. If money for research is merely a pool of funds to be fought over, and if politicians, scientists, and universities act in their self-interest, is not the sole measure of a representative's success his or her ability to obtain those funds for constituents? Our standards for holding public officials accountable diminish what we mean by "public service."

This preoccupation with private interest has also impoverished our ability to explain and improve public policy. It discourages judgments about the goodness of public policy. If public education has no immutable or transcendent purpose, why worry whether policy is achieving any objective other than satisfying the greatest number of private interests?

Such thinking is the foundation for some of the most influential recent work in public policy. For example, Morris Fiorina and David Mayhew have each written about members of Congress, their constituents, and their relationships with the executive branch. Assume, says Mayhew, that congressmen are singleminded seekers of reelection. Their actions are based upon the desire to maintain their positions, so if we can determine what actions are likely to generate the most votes, we can explain and even predict congressional behavior. Likewise, self-interest can explain the behavior of voters and bureaucrats. The latter, for example, try to maximize their budgets, and since Congress controls appropriations, the bureaucrats will trade favors for budget growth.

As theory, these premises are appealing because of their simplicity and parsimony. They do not require us to pass judgment on our congressional representatives. Their

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success is measured by how well they gauge our self-interest and act as our brokers with the other groups and individuals promoting their self-interest. Neither are citizens judged good or bad: the system works if they act in their self-interest, the only way they know how to act.

Another example is the provocative work by Terry Moe on the economics of organizations. Drawing on the work of economists such as Ronald Coase and Armen Alchian, he attempts to explain why organizations exist and how they operate. Essentially he argues that hierarchies are preferred over voluntary exchanges because they are more efficient. At the same time, organizations are built upon contractual, "principal-agent" relationships that outline the authority relationships. If we understand the incentives individuals have in these principal-agent relationships, we can understand how organizations operate.

Moe says the success of an organization depends on the efforts of all its members. Though some members may work harder than others, they all are generally paid equally. Therefore, the incentive for a worker to shirk his responsibilities is greater than the incentive to work harder. The way to deal with this problem is to have a "monitor" who will have some authority over the agents and some contractual arrangement with them.

Moe suggests that this "contractual paradigm" can help us understand public bureaucracies and indeed much of the political system. As he said in a 1984 article in the *American Journal of Political Science*, "The whole of politics is therefore structured by a chain of principal-agent relationships, from citizen to politician to bureaucratic superior to bureaucratic subordinate and on down the hierarchy of government to the lowest level of bureaucrats who actually deliver services directly to citizens." However, Moe's view depends on the assumption that public servants and citizens are not affected by values such as justice or equity or anything of a higher order than personal gain. It is rather cynical to explain the "whole of politics" as simply the accumulation of these principal-agent transactions and not concede that individuals are capable of more complicated judgments about the future of their communities and the missions of their organizations.

Consider also Brookings Institution economist Charles Schultze's classic, *The Public Use of the Private Interest*. Schultze is no stranger to nuance. He readily admits that some private actions have public consequences, and that "politics can be, in some part at least, a creative process, not simply a deterministic response to the myopic self-interest of majorities or special interest groups." Nevertheless, individuals do act in their self-interest, so Schultze suggests that to motivate them to act in publicly beneficial ways, it is necessary to manipulate their incentives—to use private interest to achieve public goals. This approach "reduces the need instill such values as compassion, patriotism, brotherly love, and cultural solidarity," values Schultze considers "emotional forces." His insight is this: if you want to change how people act, you need not change their values, only their calculation of what is in their self-interest. To reduce the consumption of gas, for example, you don't have to convert everyone into an environmentalist, you just have to raise the price of gas. Schultze's contribution, however, is not the means to discern the public interest but a way to achieve it once it is found.

We have neglected the vital proposition that government can do more than simply respond to the expressions of private interest.

The Ellwood-Patashnik article is consistent with what has become virtually the conventional thinking, even though its praise of pork barrel spending has the ap-

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pearance of unconventionality. Their proposal depends entirely on understanding the private interests of voters and politicians and then finding the right institutional mechanism for turning private vices into an acceptable outcome.

Madisonian Mischief

The idea that self-interest can be used to the public good has a long and distinguished pedigree. But this perfectly useful insight has in recent years been distorted to reach extreme conclusions. It is Madisonian thinking run amok. James Madison wrote that factions ("a number of citizens . . . actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens or to the permanent and aggregate interests of the community") were the singular problem of government. But they were impossible to eliminate in a free society. Factions sought power, and the most effective way to check their avarice was to pit them against each other. Madison also believed that public officials were seekers of power; hence the creation of checks and balances to constrain their propensities. As in Adam Smith's market, where the self-interest of everyone would check the self-interest of any one individual, the Madisonian system of government would not eliminate the power lust of public officials and interest groups (it was, after all, their nature) but would instead check and balance the proclivities of others.

On the other hand, Madison complicated matters. Man certainly has reason; how else could he calculate his self-interest? Ordinarily, this rational ability was directed inward; "self-love" was Madison's term. But Madison's dour conception of human nature also had a benign component. In *Federalist* 55, he wrote, "As there is a degree of depravity in mankind which requires a certain degree of circumspection and distrust, so there are other qualities in human nature which justify a certain portion of esteem and confidence." Madison's insightful synthesis was to promote rule by the people but only in a republican system: a representative government, where public officials deliberate reasonably, discern the public will, and filter the passions, emotions, and self-love that in an absolute democracy could override reason. It was a subtle and elegant view of government and human nature.

As good a conservative as James Q. Wilson has written that we have lost sight of Madison's view of human complexity and focused only on self-interested motivation. We have neglected in recent years the vital proposition that government can do more than simply respond to the expressions of private interest: it can be a forum for the kind of democratic deliberation that can shape the public will. The self-interest paradigm is not wrong; it is incomplete.

In *Major Barbara*, a play by George Bernard Shaw, there is a revealing exchange. Undershaft, the apparently amoral seeker of wealth and power, is attempting to convince Cusins to take over his munitions operations. But Cusins, who wants to marry Major Barbara, Undershaft's estranged and morally upright daughter, is torn. Lady Britomart is the former wife of Undershaft.

> UNDERSHAFT. Vote! Bah! When you vote, you only change the names of the cabinet. When you shoot, you pull down governments, inaugurate new epochs, abolish old orders and set up new. Is that historically true, Mr. Learned Man, or is it not?
>
> CUSINS. It is historically true. I loathe having to admit it. I repudiate your sentiments. I abhor your nature. I defy you in every possible way. Still, it is true. But it ought not to be true.
>
> UNDERSHAFT. Ought! ought! ought! ought! ought! Are you going to spend your life saying ought, like the rest of our moralists? Turn your oughts into shalls, man. Come and make explosives with me.

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> Whatever can blow men up can blow society up. The history of the world is the history of those who had courage enough to embrace this truth. Have you the courage to embrace it, Barbara?
>
> LADY BRITOMART. Barbara, I positively forbid you to listen to your father's abominable wickedness. And you, Adolphus, ought to know better than to go about saying that wrong things are true. What does it matter whether they are true if they are wrong?
>
> UNDERSHAFT. What does it matter whether they are wrong if they are true?

As the play draws to its climax, it becomes apparent that Shaw favors neither position, instead suggesting a synthesis of the two: not only an admission that we cannot ignore reality but also a recognition that we need not accept reality as good merely because it exists. It matters whether things are true; it matters just as much whether they are wrong.

As Shaw suggests that neither character has the better position, so do I suggest that the study of public policy ought to be a synthesis, not a separation, between the discovery of what is and inquiry into what ought to be. Scholars ought to acknowledge that any conceptual framework, including one that seeks to convert the self-interest of individuals into the collective outcome, has normative implications.

For public officials, policy analysts, and public administrators, the implications are even more significant. Rather than simply discovering the particular interests of individuals and groups, they should, in the words of Robert Reich, "offer alternative ways of understanding public problems and possible solutions, and thus expose underlying norms to critical examination." It is an expanded and much more difficult role because it requires potentially controversial debates about principles and values and about our obligations and responsibilities as well as preferences. The civil rights movement, for example, can hardly be explained as a collective outcome of self-interested actions. It was instead a fundamental change in attitudes.

But more immediate and less dramatic issues can also be open to a discussion of public purpose (as opposed to merely reconciling competing private purposes). The approach to developing a proposal for health care reform necessarily entails an attempt to reach a shared understanding of the problem. Interior Secretary Bruce Babbitt's hopeful search for a resolution of the conflict between loggers and environmentalists is perhaps another example. No one pretends that all private interests can possibly be satisfied, and the questions have been repeatedly asked in terms of a public interest and the broader long-term benefit of the country. In a political environment where difficult choices must be made, where we have for too long satisfied the particular demands of groups without consideration of the country's future needs, it would seem that only a massive amount of courage and political sacrifice could enable a public official to act in favor of the common good. But it may be that the solution depends less on extraordinary courage and more on reviving the idea that leaders have a responsibility to explain their actions to their constituents and to help them understand that there is a common good.

Amy Gutmann's advice on education policy applies to virtually all other policies of any consequence. She writes in *Democratic Education*:

> All significant policy prescriptions presuppose a theory, a political theory of the proper role of government in education. . . . We do not collectively know good educational policy when we see it; we cannot make good educational policy by avoiding political controversy; nor can we make principled educational policy without exposing our principles and investigating their implications.

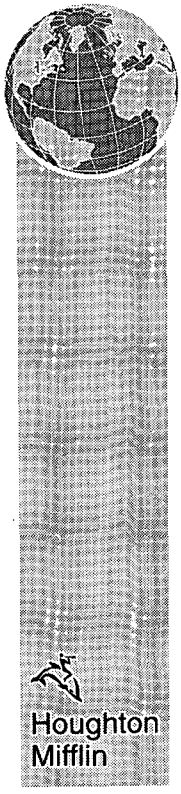
The issues facing the country, including the deficit, education reform, and support

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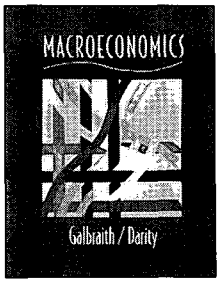
for science, require more than engineering a policy that seeks only to satisfy the most people at the least cost. We need to restore the Madisonian hope that deliberation can produce a shared understanding of public purpose. We need to regain the ability to determine what is good policy. That will likely require public officials to confront the reality that sometimes the collective good cannot be congruent with their immediate self-interests or those of their constituents.

And there are some encouraging signs. Voters do seem leery of school choice for a variety of reasons, including the civic sense that education has important public purposes which ought not to be jeopardized. Earmarks for research and development have declined by 50 percent this fiscal year, due in good part to Congressman George Brown's patient, frequent, and often angry pleas to his colleagues about the slippery slope they had been descending. Most significant is the real progress made on the deficit. Public choice theorists will have to twist their premises to unrecognizable forms to explain votes that appear to generate few electoral credits.

In the end, the Ellwood-Patashnik proposal is ideological mischief. It hinges on the premise that the answers to the deficit problem are yet additional appeals to self-interest, a curious and ironic suggestion to be found in a journal whose title at least suggests that there is another way. For no matter how ingeniously the incentives are structured for self-interested politicians, deficit reduction would appear to be impossible without a consensus that it is unjust to finance a current standard of living at the expense of future generations. And that consensus seems possible only if public officials convince a skeptical and unaware citizenry that we have responsibilities and obligations to others and that therefore more than our private interest is at stake. Using self-interest to address a collective problem diminishes rather than elevates the search for a "public interest."❖



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Talent and the Winner-Take-All Society

Robert H. Frank

WORK DISCUSSED IN THIS ESSAY

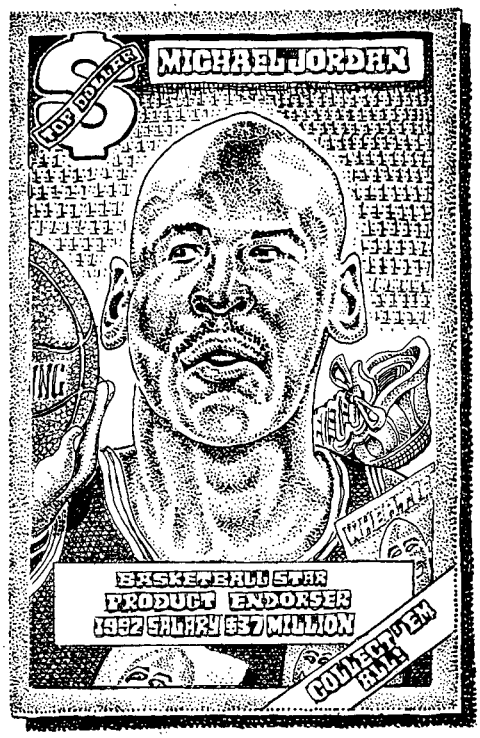
Derek Bok, *The Cost of Talent: How Executives and Professionals Are Paid and How It Affects America* (Free Press, 1993)

Although there was a flurry of denials from conservatives when the issue first received widespread public attention near the end of the Bush administration, there is no longer any doubt that the highest paid Americans have pulled sharply away from the rest of us. Yet despite a series of prominent books devoted to income inequality, most recently Derek Bok's *The Cost of Talent*, there remains little consensus on why. Many people cite changes in public policy, notably Reagan's program of tax cuts for the rich and program cuts for the poor. Others mention the decline of the labor movement, the growing impact of trade, and the downsizing of corporations.

Largely unnoticed in these discussions has been a more fundamental change, namely, the growing prevalence of what Duke University economist Philip Cook and I have called "winner-take-all markets." These are markets in which a handful of top performers walk away with the lion's share of total rewards. This payoff structure has always been common in entertainment and professional sports, but in recent years it has permeated many other fields—law, journalism, consulting, investment banking, corporate management, design, fashion, even the hallowed halls of academe.

The runaway salaries of top professionals in these fields are the subject of former Harvard president Derek Bok's book. It is a thoughtful and impassioned account of the causes of inequality and its consequences for economic and social life in America. It has helped push important but neglected issues onto our national agenda, and for this Bok deserves praise.

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Bok offers two reasons for the growing income gap: market imperfections that depress competition and the social ratification of greed that he identifies with the Reagan era. These attributions move him to join the legion of commentators who have questioned the moral legitimacy of today's top salaries. The more novel and important message of his book, however, is that the lure of top salaries has often steered precious talent toward frivolous tasks in the private sector, depleting our supply of competent teachers and public servants.

Bok is surely right that the changing structure of economic rewards has altered career choices. He is also right that many of the new choices have compromised overall economic performance, although he misses the target when he attributes burgeoning salaries to insufficiently competitive markets. Social attitudes toward greed and accumulation may well have played a part, as Bok insists. But I will argue that the driving force has been precisely the opposite of the one Bok suggests. The inequality created by the growing prevalence of winner-take-all markets stems from competitive forces having grown stronger, not weaker. This change is the result of technical and other market forces that have made top performers more valuable, and of new rules that facilitate much more open competition for their services—a movement akin to the recent wave of free agency in professional sports.

My claim, in brief, is that Bok has called attention to the right problems but has misconstrued their causes. If I am correct, the efficiency losses are larger and more widespread than the ones he has identified. What is more, the traditional notion that we confront an agonizing trade-off between equity and efficiency may have matters exactly backwards. The economic forces that have created runaway professional incomes are such that a more equitable tax structure may actually *increase* economic growth rather than inhibit it.

Top Dollar, and Then Some

By postwar standards, U.S. economic growth has been sluggish since the 1970s, and the median earner is actually poorer now, in real terms, than he was 15 years ago. During the same period, however, the top incomes in America have enjoyed spectacular growth. (For an excellent summary of these distributional changes, see Paul Krugman's "The Rich, the Right, and the Facts" in the Fall 1992 *TAP*.)

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According to former compensation consultant Graef Crystal, Fortune 200 CEOs earned an average of 150 times the salary of the average American production worker in 1990, up from a factor of 35 in 1974. These executives averaged almost $3 million in 1990, with those near the top earning considerably more. For example, Disney CEO Michael Eisner received more than $50 million in salary and stock options that year.

Top lawyers, too, have entered the winner's circle. A 1989 *Forbes* survey identified 62 plaintiff attorneys who made at least $2 million in both 1987 and 1988, and another 50 who made between $1 million and $2 million. Houston attorney Joe Jamail earned at least $450 million in 1988 alone.

The top earners on Wall Street have done even better. Not all of Michael Milken's 1987 earnings of $500 million were legal, of course, but hundreds of his former colleagues still take home multimillion-dollar salaries without bending a single regulation.

A similar explosion has taken place in publishing, where even six-figure advances for works of hardcover fiction were rare a decade ago. For authors, the watershed event was the $5 million paid in 1985 by William Morrow for the rights to James Clavell's novel *Whirlwind*. Five years later, NAL/Viking paid Stephen King $40 million for the rights to his next four novels, and Dell/Delacorte paid Danielle Steel $60 million for her next five books.

Big winners have also become increasingly common in show business and professional sports. Michael Douglas received $15 million for starring in *Basic Instinct*, and Arnold Schwarzenegger now commands more than $20 million per film. In the year before his retirement, former Chicago Bulls star Michael Jordan earned more than $37 million in salary and endorsements.

Most of these top earners have interesting, exciting jobs that they would be willing to perform for only a fraction of their current pay. The natural question, and one that is much on Bok's mind, is why do employers pay them so much?

Are the Top Earners Worth It?

Bok devotes much effort to an attempt to show that growing income inequality is made possible by the lack of effective competition. Often, he argues, the problem is a lack of information: "Those who seek to employ a lawyer or a doctor or a business executive rarely know the identity, let alone the qualifications, of nearly all of the individuals who might in fact be able and willing to perform the work desired." In other cases, there may be only one seller in the relevant market. Bok also observes that many buyers are much more concerned about quality than about price: "Vigorous price competition is more the exception than the rule, for price is seldom a prime consideration in deciding which professional to hire."

More disturbing is the malfeasance that sometimes occurs once a seller has been chosen. Lawyers may bill for services they do not perform or file superfluous briefs. Doctors may order too many diagnostic procedures. CEOs may pack their boards with cronies who vote them large salary increases irrespective of performance. These and other similar market imperfections wreak havoc on the economist's theory of competitive salary determination. As Bok writes:

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> The theory is based upon an earlier economy very different from the one we know today. In the nineteenth century, many industries were packed with small competing firms employing workers who could see what they produced each week with their own hands. As time went on, however, simple forms of production gave way to much more complex operations and ever larger enterprises. It became impossible to measure the output of individual employees, let alone be sure that the wages paid to additional workers equaled the value of the goods they produced. . . . Once industries came to be dominated by a few large companies (often bargaining with powerful unions), one could scarcely be confident that wages would correspond closely with those that [Alfred] Marshall envisaged in markets served by scores of small, competing enterprises.

Although we often see the conditions Bok describes, the top earners in many markets nonetheless appear to be worth every penny. Since Eisner took Disney's helm, the company has become one of the most profitable in the entertainment industry. Its earnings, which stood at just 15 cents per share the year before Eisner's appointment, were more than $6 per share in 1990. Author John Grisham takes home multimillion-dollar advances, but he, too, delivers on the bottom line. For a brief period during the spring of 1993, he held not only the top spot on the *New York Times* hardcover bestseller list but also the top three positions on the *Times* paperback list. Similarly, if a full accounting could be made of the extra ticket and television revenues and the extra sales of athletic shoes and breakfast cereal for which Michael Jordan was responsible, it would be difficult to argue that he took home more than he contributed. And if a top lawyer improved his client's odds of winning a $1 billion lawsuit by even 1 percent, who could argue that the client was a fool to pay several million dollars in legal fees?



Bok is right, of course, that not all big earners deliver top performance. As the CEO of RJR/Nabisco, Ross Johnson was one of the most highly compensated executives in the country even while the price of his company's stock languished at less than half the value it eventually fetched in the fabled takeover. Bok

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is also right to attribute some of the gaps between pay and performance to imperfect information. Companies know that hiring the best CEO will often mean tens of millions in additional profit each year, yet hiring committees can never be truly certain which candidate is best. In a world of incomplete information, the occasional failure is inevitable.

It is newsworthy when highly paid performers fail, but isolated failures do not signal a fundamental breakdown of competition. On the contrary, intense competition is precisely what forces companies to play their hunches in the market for CEOs. Because firms share largely common expectations about the quality of talent, failure to pay high salaries will often mean losing top candidates to rival bidders.

The kinds of market imperfections Bok cites are not new. Indeed, the effect of improved communications and falling transportation costs is to make these imperfections much *less* serious now than they were several decades ago. Buyers may not be perfectly informed, but they have more information than they used to, and this makes it more difficult for sellers to conceal past transgressions. Similarly, with increased vigilance on the part of institutional shareholders and a growing threat of hostile takeovers, the latitude for executive pay abuse should be shrinking rather than growing.

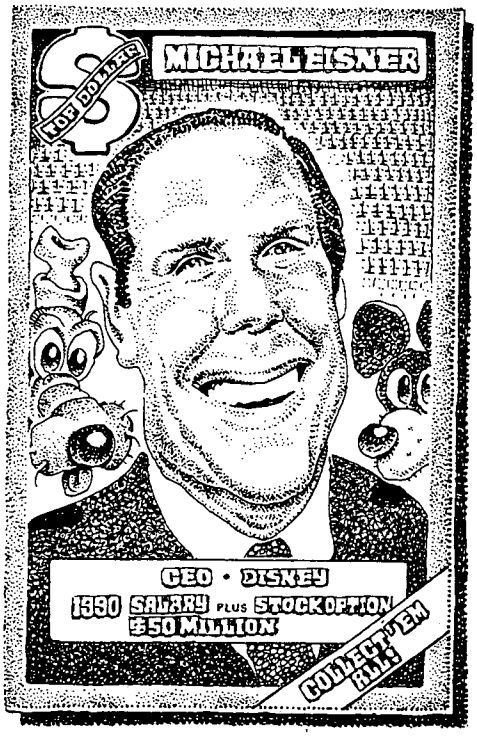
The other essential element in Bok's story is that large salaries have become socially more acceptable than they once were. Thus, according to Bok, the same market imperfections that yield such large salaries today would also have done so in the past had it not been for social norms that kept inequality at bay. The buyers of the 1970s were at least as uninformed as today's buyers, but the employers of yesteryear simply didn't *dare* pay multimillion-dollar salaries.

Bok is correct that social forces influence salaries. Who would deny, after all, that a corporate board would find it easier to approve a multimillion dollar CEO compensation package if such packages were common than if theirs were the only one? But this observation by itself cannot explain how seven-figure salaries became common in the first place. Bok blames the free-market values of the Reagan administration. Yet similar values were celebrated during the 1920s and 1950s, and executive pay was a much smaller multiple of the average worker's salary in those decades than it is now.

Winner Take All

In our forthcoming book, *The Winner-Take-All Society*, Philip Cook and I suggest that runaway professional salaries are the result not of a breakdown of competition but of the spread of markets in which the value of production depends primarily on the efforts of only a handful of top players who are paid accordingly. For example, even though thousands of people are involved in making a major motion picture, the difference between commercial success and failure usually hinges on the performances of only a few—the director, the screenwriter, the leading actors and actresses, and perhaps a few others. Similarly, even though thousands of players compete each year in professional tennis, most of the television and endorsement revenues in the industry are attributable to the drawing power of just the top ten players.

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Winner-take-all has long been a feature of markets in entertainment and sports. But in recent years, many other fields have adopted the winner-take-all payoff structure. There are two reasons for its proliferation: developments in communications, manufacturing technology, and transportation costs that have enabled the most talented performers to serve ever broader markets, which has increased the value of their services; and changes in implicit and explicit rules that have led to much more open competition for top performers, which has made it more likely that they will be paid their economic "value" as determined by the marketplace.

On the first point, consider the recent evolution of the automobile tire industry. Once a firm that produced the best tire in northern Ohio was assured of being a player in at least its regional tire market; today, sophisticated consumers choose from among only a handful of the best tire producers worldwide. Corporate performance has always depended strongly on the efforts of a handful of people at the top, but because of the broader scope of their markets, the leaders of the surviving companies have much greater leverage than their earlier counterparts did.

Likewise, as we increasingly consume music on compact discs rather than in concert halls, our demand becomes more focused on a shrinking number of musicians. Of course, not all technological change has been hostile to lesser ranked performers. Computerized typesetting, for instance, has enabled publishers to bring niche books to market with smaller print runs. But even here, the growing importance of mass communications and national bestseller lists has steadily boosted the share of total book sales accounted for by a small handful of celebrity authors. In market after market, these and other similar changes in market structure have sharply increased the value of the top performers relative to their lesser ranked rivals.

But the mere fact that a top performer contributes millions to her employer's bottom line does not by itself give rise to a commensurate salary. For that to happen, our second factor must also be present—namely, open competition for top performers' services. And it is here that the biggest changes have occurred. Put simply, there has been a dramatic increase in employer competition for the services of top performers.

Before the competition ushered in by free agency in professional sports, for example, star athletes earned only a fraction of their current salaries, despite

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their enormous economic value. In today's market, the top player who doesn't receive his due can simply move to another team. Likewise, it was once the almost universal practice to promote business executives from within, which often enabled companies to retain top executives for less than one-tenth of today's salaries. As recently as 1983, the business community expressed surprise when Apple hired a new chief executive with a background in soft-drink marketing. Today inter-firm and inter-industry boundaries are more permeable, and the greater mobility of star performers has been accompanied by explosive growth in salaries at the top.

In Germany and Japan, by contrast, inter-firm bidding for executive talent remains far less common. And although the top executives in those countries are every bit as valuable as their American counterparts, this lack of open competition has held their salaries in check. According to one recent study, Japanese CEOs earned only 16 times the average worker's salary in 1990, German CEOs only 21 times. (To the extent that the lack of bidding for rival firms' executives reflects implicit "gentlemen's agreements," these figures support Bok's view about the importance of social norms. But since the clear purpose of these norms is to *curtail* competition, he is inconsistent when he associates their breakdown with the absence of competition.)

Deregulation has provided an additional source of increased competition in the airline, trucking, banking, brokerage, and other industries in the United States. Moreover, junk bonds and other new sources of financial capital have increased the threat of outside takeovers. These developments raise the stakes of poor performance, making it all the more important to bid for the most talented players.

In sum, the evidence simply does not support Bok's claim that runaway salaries at the top are the result of insufficient competition. On the contrary, top incomes have grown because structural changes have made the top players more valuable as competition for their services has intensified.

What Price Competition?

Why does Bok go to such lengths to deny the importance of competition in the setting of top salaries? He appears to be motivated by the belief that if these salaries were somehow found to have resulted from open competition, we would be forced to accept them as legitimate. "The real injustice occurs," he writes, "because some people earn far more income than truly competitive markets would allow." But this belief is mistaken on two grounds.

First, there has never been any presumption of moral legitimacy concerning competitively determined salaries. Free-market pay depends on education, innate ability, upbringing, health, energy, luck, and a host of other factors for which favored individuals cannot claim moral credit. Nor does an individual's productivity bear any necessary relationship to her needs as a human being and citizen. Conservatives make the well-taken point that the need to maintain work incentives constrains the extent to which it is desirable, or even feasible, to redistribute income. Even so, virtually every society transfers resources from rich to poor in the name of fairness. Income inequality resulting from competi-

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tive forces does nothing to weaken the moral case for these transfers.

Second, and more important, there are many well-known exceptions even to the efficiency claims that have been made on behalf of free-market pricing. Inefficient outcomes often result, for example, when people's actions impose costs on others. Externalities like air and water pollution are instances of this type of market failure, and we have a variety of public policies whose goal is to make polluters take the costs of their actions into account.

Philip Cook and I have recently called attention to an important new kind of market failure, one inherent in the same structural forces that give rise to winner-take-all markets. Under open competition in these markets, the top performers typically receive extremely high compensation relative to their rivals, who, as in tennis, are often only marginally less able. The enormous paychecks invariably generate intense contests to choose the winners. Contests of this sort, once confined largely to sports and entertainment, have grown increasingly common in the rest of the economy. For every author who receives a million-dollar advance payment, there are thousands of others, many of them as talented, who never manage even to support themselves.

Winner-take-all markets give rise to two important forms of inefficiency. One is that they tend to attract too many resources away from markets with more conventional payoff structures. To see why, we must first examine the cost-benefit criterion for deciding how many contestants *should* enter a winner-take-all market.

When an additional person decides to pursue an acting career, for example, the cost to society is the value of what that person could have produced in some other occupation. The benefit from having the additional contestant is to raise the expected value of the ultimate winner's performance, since there is always some chance that the entrant will prove superior to the existing contestants. With relatively few contestants in the market, the expected gain from having another entrant will sometimes be high. But as more and more people enter a winner-take-all market, this gain diminishes sharply (just as the fastest runner from a high school with 1,001 students will be only imperceptibly faster, on the average, than the fastest from a school of 1,000). In an ideal economic world, we would keep sending additional contestants to a winner-take-all market until the expected gain in the value of the winner's performance was just large enough to compensate for what the last contestant could have earned in another occupation.

But when people choose occupations on the basis of narrow self-interest, we generally end up with far more than this optimal number of contestants. This happens because potential contestants ignore the fact that their presence will make other contestants less likely to win. We get too much pollution because people ignore the costs they impose on one other. And for just the same reason, we get too many aspiring actors and rock musicians—and too many aspiring Wall Street lawyers.

If the least talented contestants were to drop out and become engineers,

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teachers, or production workers, the performance levels of the winners would not fall by much, if at all. In return, the movement of marginal contestants to other sectors would result in additional output of much greater value. The first efficiency problem with winner-take-all markets, then, is that too many contestants tend to enter them, often at high cost in terms of forgone output in other markets. This problem arises even when all potential contestants are fully informed about their prospects of winning. If potential entrants are naively optimistic about their chances—as all available evidence suggests—entry will become even more excessive.

A second problem is that winner-take-all markets often generate ruinously costly investments in performance enhancement. The prototypical example is the consumption of anabolic steroids by athletes. Because these compounds enhance size and strength, athletes continue to take them despite stiff penalties against their use. From the collective vantage point, however, steroid consumption is a clear loser. Although it poses serious long-term health risks, it does nothing to alter competitive balance once it becomes widespread. Nor does the welfare of football fans as a group increase appreciably when opposing linemen average 300 pounds instead of 250.

Of course, not all investments in performance enhancement are as wasteful as anabolic steroids. For example, when automakers build engines with greater horsepower, as they have been doing for the past decade, motorists find it easier to accelerate onto crowded freeways. Yet to the extent that the demand for more power is motivated by the buyer's desire to drive a "fast" car, even this investment is partly wasteful. A fast car, after all, is a relative concept. In the 1920s, one could have the satisfaction of driving a fast car by owning a vehicle that would *eventually* reach 60 miles per hour. For a car to be considered fast today, however, it must reach 60 in under seven seconds. When all manufacturers add more horsepower, they simply raise the standard that defines fast.

Other investments motivated by the intense rivalry in winner-take-all markets actually reduce the value of the final product. For instance, because relative performance is what determines the outcome of a winner-take-all contest, one way a contestant may improve her chances is to sabotage the efforts of her rivals—as alleged in the attack on skater Nancy Kerrigan.

But even when investments in performance enhancement lead to a more valuable final product, contestants face incentives to pursue these investments well past the efficient point. The economy as a whole benefits from more timely economic forecasts, for example, but not nearly to the extent that an individual investor does. Similarly, the legal system as a whole benefits from the more carefully reasoned briefs that result when each adversary bids for a more talented lawyer, but not nearly by as much as individual litigants do.

In such cases, investments in performance enhancement are driven by private incentives that are almost invariably larger than the corresponding social payoffs. The discrepancy results from the fact that any one contestant's investment imposes costs on others, by making them less likely to win.

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Cook and I have argued that the runaway salaries of top professionals stem largely from the growing prevalence of winner-take-all markets, which are in many ways the ultimate manifestation of competitive forces. Notwithstanding Bok's suggestion to the contrary, we are not obliged to regard the resulting distribution of economic resources as either fair or efficient.

Sharing the Winnings

Our understanding of the causes of a problem inevitably influences our choice of policies for dealing with it. Because Bok sees growing inequality as rooted in an inherent weakness of competitive forces, he is hostile to remedies that rely on competitive incentive mechanisms. In lieu of greater reliance on market forces, he offers a mix of proposals drawn from an earlier liberal agenda—for example, higher tax rates on the highest incomes and greater financial aid directed at students preparing to enter those fields, primarily public school teaching and government service, that have suffered most from the talent drain.

Bok's hostility to competition also moves him to reject vogue proposals to "reinvent government" by introducing greater reliance on market forces. He opposes vouchers for the public schools, for example, and voices strong doubts about the prospects for market mechanisms to constrain health costs. Some of this hostility is justified. Bok is persuasive, for instance, in his review of evidence that recent merit pay initiatives in government and in the public schools have been dismal failures. But these initiatives failed, in my view, because they tried to import conditions into the public sector that are not found in even the most bitterly competitive corners of the private sector.

Personnel textbooks have long emphasized, and even economists have recently begun to understand, that powerful social forces militate against conspicuous pay inequality among people who work closely together. Indeed, private firms routinely employ pay formulas based on easily measured characteristics like age, training, and experience, even when those formulas yield pay differences that sharply understate observable differences in productivity. Reward for performance in the private sector shows up less as differences in pay between individuals in a given work group than as differences in the rate at which people are promoted. To observe that conspicuous pay gaps within work groups were not an effective motivational device in the public sector is thus hardly a reason to be skeptical of market mechanisms generally.

Bok eloquently defends an activist role for government and makes a strong case that more of our most talented citizens should be involved in the public sector. Yet greater government involvement need not entail the vision of government as direct provider of goods and services. On the contrary, governments often do the most good simply by requiring individuals to take the full social costs of their actions into account. Thus, for example, a group of Northeastern states eliminated a large component of the litter problem virtually overnight by simply enacting deposit laws for soft-drink containers. Bok is too quick to reject the possibility that greater reliance on similar market incentives might enhance bureaucratic performance.

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On the other hand, many of Bok's recommendations do take us in the right direction. I especially applaud his passionate call for a reexamination of American values. Material incentives are indeed given too much weight in many spheres and in any event cannot hope to solve many pressing problems. How, for example, can the threat of a fine induce someone to drive 30 minutes through traffic to dispose of unwanted pesticide properly, rather than just pour it down the drain? People will incur such costs only if they are socialized to believe it is the right thing to do.

I also share Bok's view that we have become too cynical about the role of government. Like it or not, government will remain responsible for a host of activities that shape our lives. Bok is persuasive that the harshly anti-government rhetoric of recent years has made it needlessly difficult to recruit and retain the competent public servants we so desperately need.

Bok also calls, appropriately, for higher taxes on the rich. He invests considerable effort to anticipate the objections of conservative critics by emphasizing that there is little evidence that raising rates on the top brackets will destroy work incentives. He also observes that even if higher tax rates did discourage some top earners, that might not be such a bad thing in view of the socially useless tasks many lawyers and investment analysts now perform. Although he advances these arguments skillfully, a deeper understanding of the underlying causes of growing inequality would permit us to say more.

In particular, appreciation of the growing role of winner-take-all markets suggests the possibility that higher taxes on the top earners might actually increase economic growth rather than constrain it. In winner-take-all markets, unbridled market forces attract too many entrants and lead to excessive investment in performance enhancement. The flip side of this coin is that the private incentives to enter and invest in other sectors—including government and education—are smaller than the corresponding social payoffs. Because taxing the winners' earnings at a higher rate makes both entry and performance enhancement less attractive, the net effect is to steer marginal resources away from winner-take-all markets into other sectors. In general, this will increase GNP, and not only in the cases Bok cites of lawyers and other professionals whose salaries dramatically overstate the social value of what they do. Gains will result from higher taxes even on those winners who are paid the exact social value of their services.

Market forces are ruthlessly effective in getting people to act in their narrow material interests. Often these forces produce benign social outcomes, as when the struggle for market shares leads to cost-saving improvements in technology. Other times, as in the case of winner-take-all markets, market forces guide resources in socially undesirable ways. But when market forces do lead us astray, the attendant social problems are less likely to be solved by traditional bureaucratic interventions than by creative attempts to bring private incentives more closely into balance with social incentives. ❖

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Imagebusters, the Sequel: Why TV Violence Matters

Free Market Violence

Jonathan Rowe

I was surprised that Todd Gitlin chose to scold congressional Democrats for trying to tackle TV violence ("Imagebusters: The Hollow Crusade Against TV Violence," Winter 1994). His insights regarding the media are astute, as usual. But his arguments against congressional action are mostly beside the point, and his superior and disparaging tone is not helpful. Gitlin dismisses concern about TV violence as a middle-class neurosis, a revival of the "iconophobia" that arose early in the century with the arrival of motion pictures. He ridicules senators addressing this issue as inferior intellects who aren't up to facing real issues like gun control.

Well, so what if the people who raised the issue early in the century happened to be middle class? The question is whether they were onto something, which they were. Similarly, what difference does it make that some advocates of action on TV violence are not strong on gun control? Regrettably, Gitlin gets so stuck in the disparagement mode that he never gets to the real issue: Are there ways to deal with violence in the media that do not compromise free speech, do not give more power to government censors or expert panels, but rather give more power to parents and citizens generally?

There are, and it's important to talk about them. Media violence isn't just about kids and crime. It's also about citizenship in a media age. Ultimately, it's about the chasm between the Right's family-values polemics and its free market hedonism, which gives rise to the very values it deplores on the tube.

Legislation isn't always the best answer, of course, especially where First Amendment values are concerned. But sometimes new laws are needed to enable citizens to express *their* views; the First Amendment does not exist for the media alone. It took legislation, after all, to create the modern corporation, including those in the mass media. The broadcast and cable industries are built on legislation, too, and more will be needed to establish the "information superhighway." Now isn't it possible that legislation is needed to right the balance and to give citizens more tools to deal with the media deluge that government helps create?

Gitlin seems to think that to address television violence precludes action on other fronts. That is silly. It hardly needs saying that the epidemic of violence in America has many sources and that Congress must do many things to reduce it. Even the toughest gun control conceivable would not make crime disappear tomorrow, any more than action on TV violence would (or more jobs and better schools, for that matter.) Besides, Gitlin is just plain wrong in suggesting that TV violence is a refuge from gun control. Some members of Congress are strong advocates on both fronts.

Free speech is a more serious concern. But to make Arnold Schwarzenegger the poster child for the First Amendment is a stretch. One could argue just as well that guns and gore are impediments to free expression, a kind of toxic placebo that crowds out a broad range of alternatives.

As we all know, the media corporations

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that squeal about censorship practice it every day, in news as well as programming. They censor out zaftig female newscasters and bad news about corporate owners or sponsors. Back in the '50s, the networks censored reports on the health effects of smoking. Cigarette sponsors prescribed heavy doses of video violence instead. "Although other crimes may be introduced, somebody must be murdered," read the instructions to writers for one early CBS show called *Man Against Crime*, which was sponsored by Camel cigarettes.

In other words, the choice is not between free speech and censorship. It's between the corporate media's impediments on free speech and a broader framework in which the viewing public has a more effective say. Restraints on violence, if properly crafted to amplify public opinion rather than set loose government censors, could actually encourage a flowering of creativity on the tube.

Regrettably, Gitlin doesn't explore this possibility. Instead he follows the industry in assuming that all approaches will lead to heavy-handed censorship. Next thing you know, the Gestapo will be at our doors to confiscate *TV Guide* and Shakespeare will be banished from the tube (as though the networks hadn't banished him already).

That's more silliness. The V-chip, promoted by Congressman Ed Markey of Massachusetts, is one solution based on parent and citizen power, rather than censorship. It's basically just a high-tech lock that would return control of the TV set to parents. Critics suggest that parents are lazy: if you don't want the kids to watch, just turn off the set. That's a fair point, for well-off families with a parent—or servant—at home. But working and single parents can't stand guard at the set 24 hours a day. The V-chip wouldn't violate free speech and would give parents a more effective way to turn violence off.

Another approach is the one sponsored by Senator Byron Dorgan of North Dakota, for whom I work. Dorgan's bill would provide information to parents and others about the violence level of prime-time and children's shows, including who sponsors the shows. Nonprofit groups would conduct the surveys through small federal grants. They would be done four times a year, including at least one sweeps week. They would not purport to judge shows or evaluate the context of the violence. Rather, they would simply alert parents to shows they might want to take a closer look at. Contrary to media protestations, Shakespeare would be safe. He might even get to make an occasional appearance.

Finally, why does Gitlin think it's such a bad idea for Democrats to talk about family values? For years, conservatives have blamed liberals for the erosion of those, along with many other things that should be laid at the feet of the executives who attend their $10,000-a-plate dinners. A columnist for the *Washington Times* even blamed the public fixation on Tonya Harding and the Bobbits on the "liberal media."

Talk about projecting one's own faults onto the other guy. The media circus surrounding Tonya et al. was not the work of "liberals." It was the "marketplace" in action—corporate media style. It's what happens when enterprise is driven solely by a desire to make money. Dan Quayle was right: the media generally embody crummy values. Where he's wrong, and downright cowardly along with the rest of the Right, is in the nature of those crummy values and where they point the finger.

Instead of reflexively defending *Murphy Brown* or violence on TV, progressives should pursue the underlying premise of the Right's critique. When a reviewer for one right-wing journal proclaims that TV does not reflect the nation's values but seeks to "move audiences towards the media industry's vision of values," that's a startling admission. It's saying—free market theory notwithstanding—that corporate producers pursue their own agendas and don't just serve the needs of their customers. Hmmm. What about oil companies, the packaging industry, and all the rest?

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That's a debate that progressives should be eager to engage. When the overwhelming majority of Americans think there's too much violence on TV but the media gives it to them anyway, it says as much about mass markets and corporate power as it does about the media.

So let's hold them to their own polemics. The right likes to talk about responsibility. How about some responsibility where the corporate media and its advertisers are concerned? The right likes to talk about the sanctity of the home and family. How about helping families close their doors to the incessant barrage of the commercial culture? This isn't just politics. It's a real problem in America, and one that Democrats should start to address—not least because Republicans won't.

The Either/Or Fallacy

Sissela Bok

Todd Gitlin takes aim at liberals who advocate steps to reduce media violence. He blames them for making common cause with Dan Quayle and other conservatives in efforts to "demonize the media." He points to the naiveté of assuming that the media are the main obstacles to equality and justice and domestic tranquility. The message behind "the clangor of current alarms about television violence," he claims, seems to be, "Guns don't kill people, picture tubes do."

No sense of guilt need ensue, however, for either liberals or conservatives who ignore ideological boundaries as they speak out against media violence. The fact is that the great majority of Americans, no matter what their political persuasion, now view the levels of television violence in America with alarm. According to a Times Mirror Center survey made public in March 1993, the proportion of Americans who regard TV violence as harmful to society has risen from 64 percent in 1983 to 80 percent in 1993. In December 1993, the *Los Angeles Times* reported on a survey showing that "almost 4 out of 5 Americans believe violence in television programs directly contributes to the amount of violence in society."

Most liberals who hold such beliefs, moreover, fully share Gitlin's concern over the havoc wrought by firearms in our society. Far from imagining that picture tubes, not guns, kill people or that the media are the main obstacles to domestic tranquility, most of them would applaud his call for serious debate about guns and bullets. Conservatives, too, are shifting on this issue. Increasingly, Americans are concluding that one-dimensional approaches to the multiple roots of violence are bound to fail. As Dr. Deborah Prothrow-Stith, co-author with Michaele Weissman of *Deadly Consequences*, insists: "It's not an either/or. It's not guns or media or parents or poverty."

Gitlin himself accepts most of these factors as contributing to the present levels of violence. He would presumably include them in the serious debate about guns and bullets that he rightly sees as indispensable. Why not, then, also include the role of TV violence? Why single out Attorney General Janet Reno, Senator Paul Simon, and others who have sounded the alarm as suffering from "iconophobia and moral panic"?

Gitlin's summary dismissal of their arguments is the more surprising since he expressly agrees with them that there are links between TV violence and societal violence. He refers, as they do, to *Violence and Youth*, the 1993 report commissioned by the American Psychological Association, and he quotes its unequivocal conclusion regarding the correlation between higher levels of viewing violence on television and increased acceptance of aggressive attitudes and increased aggressive behavior.

But correlation, Gitlin points out, "is not necessarily cause." We can't know how much societal violence is actually caused by media violence. Yet our inability to pinpoint cause and effect so precisely has not stood in the way of discussing and promoting

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policies to curtail cigarette smoking and drunk driving; it is not clear, therefore, why it should block policy debates about TV violence. Indeed, the television industry has already taken seriously the need to curtail the glamorization of smoking and of drunk driving on its programs, without requiring absolute documentation of the causative links between TV viewing and higher incidence of such conduct.

An approach to causation more commonly used in considering societal hazards is that of probabilistic causation. Viewed in this perspective, it is not necessary that a suspected risk, such as the cigarette smoking that is thought to play a causal role with respect to lung cancer, produce that effect in all or even most cases, nor that it be the only or the greatest cause of that effect. Rather, the more appropriate standard is, as law professor Fred Schauer points out, that it "increases the incidence of the effect for a population and increases the likelihood of the effect in an individual case."

Even so, Gitlin suggests, the harmful effects that can be linked to TV viewing are not nearly so great as to justify the concern by Reno. He estimates that the "copy-cat crimes" reported in the media result in no more than 100 deaths per year, or "0.28 percent of the total of 36,000 murders, accidents, and suicides committed by gunshot in the United States in 1992."

Other commentators, taking more than copy-cat crimes into account, have arrived at sharply differing figures. Psychiatrist Brandon S. Centerwall has concluded from large-scale epidemiological studies of homicide in America and abroad that "if, hypothetically, television technology had never been developed . . . [v]iolent crime would be half of what it now is." If so, there would be 10,000 fewer homicides today, he suggests, 70,000 fewer rapes, and 700,000 fewer injurious assaults. Still others have estimated that TV programs may contribute incrementally to 10 percent of violent crime.

All the more reason, given such diverging claims regarding the harm from television violence, not to leave its role out of serious public policy debate—the kind of debate that Gitlin already advocates with respect to guns and bullets. Such a debate also should consider the cumulative effects of exposure of children to violence, not only on television but in their homes and in communities: the harm to children from witnessing violence, even when they are not themselves beaten or otherwise abused, is too often neglected.

But Gitlin has a further reason to view television violence as receiving disproportionate attention. He suggests that concern about its role is not only misplaced, given the low levels of societal harm he attributes to it, but an evasion of the genuine issues at stake. People engaged in "the symbolic crusade against media violence . . . are saying, in effect, that they either don't know how to, or do not dare, do anything serious about American violence."

For children, however, there is nothing purely symbolic about television. They are unable, through at least the age of three or four, to distinguish between fact and fantasy; even older children rarely manage to keep "real life" violence and vicarious violence in watertight compartments—least of all those for whom the similarities between what they see on the street and on television are only too evident. The experiences of children who know violence at close hand testify to the role of television violence not as a unique risk factor but as one interacting with many others; even, at times, as the only "safe" activity for children living with dangers no one ought to have to endure in our society.

Still, Gitlin's is a natural first reaction for anyone convinced that TV violence is dwarfed by other causal factors such as poverty, family breakdown, the availability of firearms, or substance abuse: Why not begin with what is truly important, rather than waste time and energy on the contents of TV programming? Indeed, critics of gun control level the same type of accusation against those who, like Gitlin, stress the devastating role of guns in our society. To these critics, the focus on guns is unlikely to

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make much of a dent in reducing crime and merely distracts attention from the real causes of violence and serious remedies.

Such criticisms are valuable insofar as they caution against undue stress on any one causal factor and against assumptions that only one remedy is therefore needed; but not when they are used for summary dismissal of any such factor. It is as important not to dismiss or downplay factors prematurely in the case of violence as when it comes to other complex, multidimensional social problems. Take heart disease: to be sure, there are disagreements about how best to reduce its prevalence; but few critics maintain that, just because some risk factors such as smoking or heredity or cholesterol contribute more than others to this prevalence, there is reason to leave the latter out of consideration. On the contrary, research and inquiry clearly have to continue regarding each one, including those thought to be of lesser magnitude.

In the past few years, scholars, community advocates, health care professionals, and public officials have increasingly come to view the problems of violence from a public health perspective, in addition to legal and other perspectives. The public health perspective, long familiar with respect to heart disease, cancer, motor vehicle injuries, and other major causes of death and disability, allows a wide-ranging and integrated exploration of the incidence of different forms of violence, of possible risk factors, and of approaches to risk reduction and prevention.

Such a public health perspective serves as a refreshing antidote to any urge either to address complex problems in terms of only one risk factor or to dismiss concern with any one factor on the grounds that it is not the only one or even the most significant one. Too often in the past, the discussion of violence in America has petered out in stand-offs among advocates of one or more "real" causes and "serious" remedies.

If the current debate is to have a chance to go beyond such stand-offs, it must take the public health perspective into account while also giving voice to the individuals with most at stake in the outcome of the violence debate—the parents and neighborhood groups struggling against sometimes overwhelming odds, the organizations mobilizing to combat violence, the pediatricians and social workers who work to help individuals overcome its consequences, and above all, the children who know violence in their daily lives.

Todd Gitlin Responds:

Rowe says "the real issue" is violence in the media. This is the nub of our disagreement. To me, the real issue is flesh-and-blood violence. On a scale of significant American evils, I rank violence in the media low—certainly lower than poverty, chronic unemployment, murder, rape, the devastation of cities, the battering of women.

Let's get serious. Where are the urgent-sounding, now-or-never press conferences on these subjects? Where are the media exposés? Where is the steady passionate outcry? Where are the petitions? Where are the filibusters against any spending bill that doesn't contain a measure to create a Civilian Conservation Corps to put unemployed youth—at greatest risk of killing and being killed—to constructive work?

I don't, as Rowe alleges, think "that to address television violence precludes action on other fronts." But I observe that we have been through decades of these cycles of alarm about television violence while the actual devastation of our cities proceeds like a long, wasting disease. I have just had the depressing experience of reviewing several academic studies of the association between television and violence from the early 1970s. Wearily, each of them alludes to socioeconomic causes that presumably play a part in generating flesh-and-blood violence. Many point out that if television is a factor in causing violence, it is only one factor. Rowe is right that one *needn't* use the

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issue of TV violence as a refuge from gun control. But is it not of some, er, interest that certain prominent would-be censors of TV violence—I mentioned Senator Ernest F. Hollings in particular, co-sponsor of the Children's Protection from Violent Programming Act of 1993—opposed even the most meager gun control provisions of the Brady Bill? Does this not speak to, at the very least, a certain irony?

I have no quarrel with Representative Markey's V-chip. I support it on the ground that parents deserve help controlling their TV sets, just as they need Off-buttons. But I think it absurdly naive to imagine that V-chips are going to make a dent in the 38,000 gunshot deaths that took place last year in America.

I don't know where Rowe gets the notion that I think it's a bad idea for Democrats to talk about "family values." I think it's a fine idea. But again, let's do it seriously, not demagogically. Take the *Murphy Brown* controversy. Over the past two decades, the proportions of babies born out of wedlock have soared *in every industrialized country.* They have doubled, tripled, and in the United Kingdom, *quadrupled*—despite Margaret Thatcher's heroic efforts to shred the social net and restore the stigma to the "undeserving poor." *Murphy Brown* did not influence marriage rates in London—or in Japan, where illegitimacy has also doubled, though the doubled rate is still minuscule. To talk about family values seriously would be to talk seriously about the 20-year-long decline real wages; about publicly funded child care and parental leave, and, yes, about the nihilism of popular culture, as well.

Rowe wishes to "enable citizens to express their views," and I certainly join him. In "Imagebusters," I advocated the most vigorous and direct expressions of disgust directed toward media figures who clutter the airwaves with slashes and slime. I'm all for picketing the so-called responsible executives of General Electric, CBS, ABC, Fox, the various producers and syndicators and cable operators at their offices and homes. (What shall we make of their, and their advertisers', family values when they deface the values that circulate through other people's living rooms? The values that matter to them are market values.) I'm for running ads in the papers naming their names. I'll happily join Rowe raising hell at their stockholders' meetings. From what I know of it, I'm not particularly exercised by Senator Dorgan's bill to provide information about the "violence level" of TV shows, though there's no way to compute an objective measure. It's fine to inventory the names of advertisers who subsidize garbage.

But let's go further. Let's charge the TV license-holders, who engorge themselves at the public trough, fees that are hefty enough to finance several serious public television networks. For that matter, let's institute term limits for license-holders. The culture would certainly benefit. And I predict that, still, at the turn of the next millennium, with some 1,500,000 handguns having been manufactured every year (at the current rate) and millions of bullets to fit them, with millions of kids spilling from wrecked families and wrecked neighborhoods into the streets and getting lifelong training in nihilism, we'll still be tearing our hair out over American violence.

Sissela Bok cites Dr. Brandon S. Centerwall's epidemiological research on the link between television exposure and violent crime. I have read Dr. Centerwall's reports and recommend a close reading. (The chief one is "Exposure to Television as a Cause of Violence," in *Public Communication and Behavior*, ed. George Comstock, Vol. 2, 1989.) He checked homicide rates among white South Africans, Americans, and Canadians during the years following the introduction of television. (In South Africa, this didn't happen until 1975.) Ten to fifteen years after television spread throughout these societies, there was a doubling of the homicide rate among whites. Centerwall was unable to explain this startling shift by changes in age distribution, economic growth, civil unrest, or the availability of

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firearms, among other factors. Even the rate of murder committed without weapons doubled in the U.S. and Canada between 1965 and 1975. An impressive finding indeed. Still, he doesn't consider the possibility that the Vietnam War unleashed murderous impulses in the United States. (According to his figures, it was about 1967 that the white homicide rate in the United States got back to the level of 1945.)

If one allows for the weakness of all such studies, namely that correlation isn't cause, Centerwall has made an interesting argument. It is not, however, an argument against *violent* television. It is an argument against *television*. If television is pernicious —and I am inclined to believe it is, in spades —is this because of depictions of violence or other reasons? Just how violent was the television of the 1950s that Centerwall holds responsible for exploding, like a time bomb, in the minds of exposed children years later? Might it be that TV editing is unnerving? That the everyday broadcast of images of wealth and ease on television, especially when broadcast into the homes of children who have neither, incites envy and rage? Or that there's some other effect of television watching as such? Centerwall's research doesn't tell us. It doesn't ask.

In any event, I see no reason to believe that television violence occupies the same causal position with respect to flesh-and-blood violence that smoking does with respect to lung cancer or alcohol does with respect to drunk driving. Moreover—no trivial concern— it is far harder to pin down just what constitutes violence on television than it is to pin down just what constitutes smoking or drinking. Prohibition is problematic enough; *vague* prohibitions trifle with the First Amendment in an especially troubling way.

I have no quarrel with a public health approach if it is without illusions and keeps its sense of proportion. In the case of violence, there are plenty of real smoking guns, and I persist in thinking that the current crusade is choosing easy politics and an easy target—Hollywood amorality—over the far tougher project of chipping away at the motives and means of murder.❖

Is Clinton's national service more than a band-aid?

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(continued from page 14)

based, non-employment related system.

Neither of these amendments does more than make things possible. To move further would require a radical restructuring of the president's approach. Nevertheless, even these changes would increase options and enhance competition and public debate. For that reason, they should appeal to the constituency that believes in the advantages of social insurance over employer-mandated mechanisms, as well as to those who believe in marketplace competition and are convinced that the public sector cannot compete effectively with the private sector. Let government (Medicare Part C, tax-financed care in some states) compete with private insurance, and may the better approach win.

Doctor's Orders and Patient Choice

Jeffrey B. Morris

Among the least popular and least understood features of the Clinton plan is the proposal to create insurance purchasing alliances. Supposedly, the alliances would be just another layer of bureaucracy on top of the existing system of insurance company managed care, but this caricature is a dangerous misconception. In reality, creating alliances is the best way to prevent insurance companies from taking over the entire system, as seems likely to happen if present trends continue.

Under Clinton's plan, consumers and employers would pay premiums to their regional alliances. Consumers would then be free to choose from many "accountable health plans" certified by the alliances. Some of these AHPs might be sponsored by insurance companies, but others would be networks of physicians and hospitals, HMOs, or even state single-payer plans. This would be decidedly different from the current arrangement, wherein employers choose an insurance company that has previously arranged an exclusive relationship with a provider network, usually without input from consumers.

To critics, the alliances represent "more layers of bureaucracy," "increased government control," or even "socialized medicine." Paul Ellwood, for example, of the Jackson Hole Group, wants to weaken the influence of alliances by allowing employers to opt out and purchase insurance on their own. He argues that the traditional relationship between insurance companies and employers has created a group of very sophisticated buyers who have leveraged down prices.

But doctors in California know too well the result of that relationship: insurance-run managed care. Although most of us do not object to the concept of managed care, we are alarmed to see insurance companies selling HMO products to employers and then escaping from their traditional role as risk underwriters by shifting the risk to physician providers.

In this situation, physicians have been stripped of control over how they take care of patients but are still blamed for medical cost increases. Meanwhile, insurance companies pay bonuses and dividends to CEOs and shareholders, shifting a greater percentage of the health care dollar away from direct patient care and into corporate profits and expensive marketing plans. Physicians

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are left with the risk for care —not to mention a growing morass of quality-of-care concerns.

The Clinton plan would fundamentally shift control back where it belongs: to the physicians and patients. The bargaining for health care services will take place not between insurance companies and employers but between consumers and providers. The insurance companies would no longer be able to contract with an employer and "deliver" groups of patients to one provider network over another; in addition, employers would no longer have the administrative chore of selecting an insurance plan for their employees. *Through the alliance mechanism, that responsibility would revert back to each citizen along with the right to choose individual doctors.* Each accountable health plan would have an equal opportunity to compete, both on cost and quality, for consumers who directly choose their plan.

For physicians, this provides a historical opportunity to unite as AHPs. True, most physician networks would ultimately join with a hospital, an insurance company, or with other business organizations to vertically integrate into AHPs. But the insurance companies would be competing to become partners: they would have to offer competitive prices for the services they bring to the table, such as administration, management, and marketing.

We cannot turn back the clock to a time of unlimited health expenditures. Managed care is already a reality. The fact that this reality places physicians and consumers alike in roles subservient to the insurance industry is something President Clinton has attempted to change. Doctors can learn new ways to practice medicine in a budgeted environment, as long as we can channel most of our resources into direct patient care. Those who either unwittingly or knowingly attempt to undermine this legislation could destroy a golden opportunity for health professionals to regain the stewardship of health care in this country, in partnership with citizens.

Beyond the Economic Model

Ezekiel J. Emanuel

Along with universal access and cost control, accountability has become a mantra of health care reform. Doctors are supposed to be accountable for the results of their decisions and treatments. Managed care plans are supposed to be accountable for patient satisfaction and efficient, high-quality care. Health alliances are supposed to be accountable for controlling costs and ensuring access. But what do we mean by accountability? And how should we institutionalize it?

The proponents of managed competition unabashedly offer an economic conception of accountability: make providers feel the pressure to survive in a competitive marketplace. Patients, meanwhile, will act as consumers, choosing among the competing plans based on price, quality, and service.

Health alliances will police the whole market. They will ensure truth in advertising by health plans, as well as compliance with the minimum standard benefit package. They will measure patient satisfaction and monitor providers' clinical judgments and outcomes, publishing all this data in a sort of "Consumer Reports" for the patient-consumers. Dissatisfied consumers can leave plans and seek a better combination of price, quality, and service.

The economic model of accountability has always been afforded a privileged position in American society. Yet in some spheres—most notably individual rights, socially guaranteed opportunities, and sometimes the environment—we reject treating goods as commodities and using the market for accountability. While we are not always consistent or successful in this endeavor, our belief that some spheres are off-limits to markets raises the question of

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whether the economic conception of accountability is the right one for health care.

Americans condemn pharmaceutical companies that accrue high profits while millions of Americans forgo necessities to buy medicine. Similarly, we restrict physicians and hospitals that act like businesses in refusing to treat patients who cannot pay or in making profits on self-referral. And when hospitals act like profit-making businesses, the public call is to force them to reaffirm their public service missions. Probably the most telling piece of evidence supporting the notion of health care as a socially guaranteed right is President Clinton's repeated insistence that universal coverage is the single value that cannot be compromised.

One alternative is a political conception of accountability Here, health care is viewed as a socially guaranteed benefit and individuals act not as consumers but more as citizen-members. Managed-care plans are less businesses and more democratic policymaking bodies. The patient's loyalty to a particular physician and health plan is not viewed as an irrational quirk distorting ideal economic behavior but a virtue to be encouraged. In a political conception of accountability, the main mechanism for expressing dissatisfaction and assuring accountability is not "exit" from the organization in search of a better one, but active participation by patients in evaluating their health care plans and in making critical administrative decisions affecting provision of services.

If we are going to reject—or at least temper—the economic model of accountability and infuse more political accountability into health care, then certain institutional adjustments to the Clinton plan will be necessary. For example, we could ensure enrollee involvement by requiring that all managed care plans have a board of directors elected from among its members or—even further—by requiring that managed care plans be patient cooperatives, like Group Health Cooperative of Puget Sound, one of the oldest HMOs in the country. We might also create a special pool of capital to help fund managed care plans by citizens' organizations or other community-based groups. We might also switch the focus of cost control from pressure on individuals to select the cheapest health plan—which undermines loyalty—to strong global budgets for each plan.

Everyone accepts the goal of more accountability in health care. But we should not let the economists and their allies dictate the conception of accountability.

Don't Forget Public Health

Joan E. Ruttenberg

Whatever other criticisms the Clinton plan may deserve, it is beyond debate that achieving universal access to medical care will be good for the public's health. The plan also gives welcome emphasis to prevention and primary care in several ways: coverage for well-child and adult screening services, promotion of primary care physicians and advanced-practice nurses, more money for health facilities in schools and medically underserved areas, and support for nonmedical services—transportation, child care, translation—that enable people to better use existing services. All will improve health.

Yet much illness and injury can be traced not to a lack of medical care but to dramatic rips in the social fabric: addictions, violence, homelessness, malnutrition, adolescent pregnancy, and environmental contamination, among the most damaging. One-on-one clinical encounters, even of a preventive nature, are unlikely to redress or prevent medical problems with such deep social roots. Expanding treatment alone, therefore, will not create good health, nor will it contain health care costs.

The Clinton bill goes further and creates,

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under the rubric of "public health initiatives," a pool of federal money to fund state and local public health action. Grants would support traditional public health functions (e.g., protecting food, water, and housing quality, educating the public, and performing lab services, training, and data collection). Money also would be available for innovative community-based public health projects, expanded substance abuse and mental health services, and National Health Service scholarships.

Increased federal support for chronically underfunded state and local public health activities is certainly desirable. Universal coverage may even free up state resources currently devoted to direct medical services. The bill's funding categories are general enough to encompass many innovative state efforts. And maintaining state discretion respects both political reality and state expertise. Yet when all is said and done, the plan essentially funnels additional money to the existing public health structure, without assessing whether that structure, or its traditional priorities, is adequate to the job.

The current national debate affords Clinton an unparalleled opportunity for leadership on the paramount role of social investment in engendering health. In other contexts, Clinton has rightly emphasized the potent connections between social and medical ills, by seeking full funding of the Women with Infants and Children program, for instance, and by identifying gun control and violence as health care issues. He is the first president in recent memory to make these links, and for this alone he deserves high praise. To go further and include broad-reaching reforms of issues not traditionally seen as health-related in a health care proposal might well be political masochism. But failing to do so may doom cost-containment efforts, leading to public disillusionment with reform. At the very least, Clinton should shape the debate to highlight the connections between social problems and health care.

Of course, nothing would motivate increased federal attention to public health and social investment like full, unvarnished responsibility for the costs of illness brought about by preventable social problems, and a clear connection drawn between the two. By forgoing a single-payer system and retaining private, employment-linked insurance, the Clinton plan layers employers, health plans, insurers, and regional health alliances between the cost of care and the cost of prevention. These layers will mute the economic message that expensive, preventable health care needs might otherwise bring to government. Clinton will need to redouble his efforts for public health investment to counter this misleading silence.

Avoiding Catastrophe

Shoshanna Sofaer

The president has threatened to veto any health care reform legislation that does not include universal coverage. But meaningful universal coverage is not a given; if it isn't fought for, it will be gutted, delayed into the twenty-first century, or simply forgotten. Within Congress, the real threats to the president's plan come from those who are opposed to employer mandates and who would be even more opposed to the financing mechanisms found in single-payer alternatives.

But in seizing the day to fight for universal coverage, advocates should keep in mind that health policymaking is an ongoing, long-term process with a history and a future. The most compelling event in our recent health policy history was the fiasco of the Medicare Catastrophic Coverage Act, passed in 1988 and repealed in 1989 in reaction to voter outrage about its financing and cost. Among the many lessons of this experience, one is that we must create a policy

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context in which universal coverage is sustainable in the long run, that allows it to become an everyday fact of life in America, as it is elsewhere in the developed world.

Even if we pass a bill with universal coverage, its opponents may well keep on fighting. They will pounce on every indication that reform is costing more than expected and blame the high costs on coverage of the poor and previously uninsured. If, as in the case of Medicare Catastrophic, it becomes clear that those who are paying the most are getting little in return, the ground becomes fertile for frightening the public and Congress into carving away benefits, lowering subsidies for low-income people, or increasing deductibles and out-of-pocket cost ceilings. In essence, this would shift more of the cost of reform to the shoulders of those who need health services most and can afford them the least. Without a doubt, health care reform has a lot more to offer to a lot more people than did Medicare Catastrophic. However, it will also gore the oxen of many more well-funded special interests. Given those interests, sustainable universal coverage requires a plan that resonates to the needs of most Americans, while it attends to the most vulnerable.

While we can maximize the chances for universal access by careful legislative crafting, no plan can, in itself, guarantee such access. It ultimately depends on the decisions and actions of thousands of individuals and organizations. Vigilance, and information to make vigilance possible, will be essential to identify situations in which individuals are being denied their rights and to identify patterns where groups such as the disabled, minorities, and residents of remote areas and inner cities continue to be underserved. The plan must provide protected resources for collection and analysis of essential data on access, quality, consumer satisfaction, and cost. Health plans, health alliances, indeed the entire system, will be truly accountable only if we have sound and democratic ways to set performance standards and equally sound ways to assess and improve system performance.

The Clinton plan is best viewed as a critical turning point in health policy. If we can solidify universal coverage as a fundamental principle, we can move on to the longer term task of increasing the value we get from our health care system, in terms of care and, most important, in terms of the health of the American people.

Who Watches the Watchers?

Robert Restuccia

The health care consumer has officially been discovered. Acknowledging that the current system is responding to the needs of providers, insurers, and drug companies but not to the needs of the American people, the president's Health Security Plan greatly expands the role of consumers as a counterforce to the special interests.

The Clinton plan gives consumers a critical role in determining the direction of the system at the state and local level. A seven-member National Health Board, appointed by the president, will ensure that states conform to statutory standards for benefits and data collection, will enforce overall spending limits, and will develop insurance market regulations. A National Quality Council (without consumer representatives) will develop quality and access standards, including measures of consumer satisfaction.

Within the national standards, states will have broad discretion to act. States will be able to choose a single-payer option or require plans, including large, self-insured corporations, to all pay the same rates. The federal government will distribute funds to each state for health care reform planning. Each state will be required to set up one or more health alliances in their geographic

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regions.

It is within the alliances that consumers are expected to exert their influence over the system. States will have discretion in determining the form of the alliances. They can be non-profit organizations, public authorities, or state agencies. Individual consumers and employers will each make up half of the alliances' boards. By bringing the buyers of care together, the alliances are set up to act as a counterforce to the providers and insurers.

Under the Clinton plan the alliances will negotiate rates with health plans but will be much more than brokers of health insurance. They will have significant oversight responsibilities with respect to health plans. The alliances will monitor plans to ensure that all enrollees receive the uniform benefit package. Alliances will be in charge of negotiating the premiums with health plans to ensure they live within the overall budget cap. They will play an important role in disseminating information about quality and assisting consumers in making decisions about plans. Alliances will also have great discretion in determining the policies to meet the needs in underserved areas. Additionally, alliances will be required to provide an ombudsman to assist consumers with problems. But unless the capacity of consumers to participate is greatly enhanced, the crafting of a new system will remain in the hands of the special interests.

As now structured, several factors will blunt the effectiveness of consumer participation. First, the alliance boards will represent several interests: consumers, employers, and state government. It is unlikely that the consumer viewpoint will prevail, especially given the structural disadvantage. Other parties, both the regulators and the regulated, are likely to be part of an organization—a business, a hospital, a physician group practice—giving them greater access to resources than consumers have. Moreover, these parties are likely to be part of a network or association—a medical society or a chamber of commerce—that can provide both technical assistance and a means of communication to other organizations with a common interest. Consumers alone lack these institutional connections.

Second, the relative power of the alliance board and staff also limits the effectiveness of consumers. How much authority will really rest with the board, and how much will devolve to the staff in charge of day-to-day operations? Because they lack a connection to outside supporting organizations, consumer board members will depend on alliance staff and be less likely than other parties to maintain an independent viewpoint. In addition, unless consumer representatives are linked to their constituency, there is the danger of co-optation.

The Clinton plan needs to support consumers in a number of ways. Alliance boards must be structured so they are as independent of state administrations as possible and reflect the diversity of the alliance members. There needs to be technical support for consumers on the alliance boards so nonexperts can understand issues that confront them and participate effectively. Most important, the legislation must recognize the need for independent consumer organizations. These organizations will provide support for alliance representatives and organize a consumer constituency that will hold alliances accountable. Creation of such organizations should be required through alliances and should be financed through a dues checkoff on premium payments or through federal grants.❖

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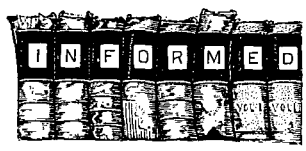
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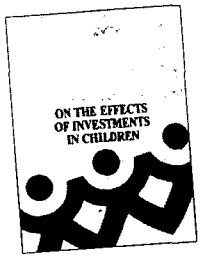
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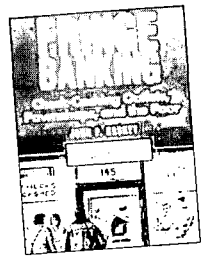
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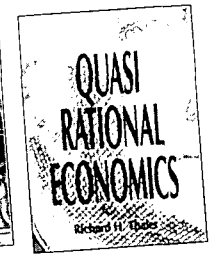
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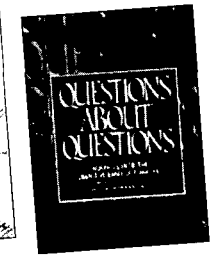
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